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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957

No. 602

CITIES SERVICE COMPANY,
Petitioner,

—*against*—

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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November 8, 1957.

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IN THE

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OCTOBER TERM, 1957

CITIES SERVICE COMPANY, *Petitioner,* —*against*— SECURITIES AND EXCHANGE COMMISSION, *Respondent.*	No.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Cities Service Company prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this case August 14, 1957.

Opinion Below

The opinion of the Court of Appeals is reported at 247 F. 2d 646 and is printed in the Appendix at 3a-18a.

Jurisdiction

The judgment of the Court of Appeals was entered August 14, 1957 (App. 1a–2a; R. 132). The jurisdiction of this Court is invoked under Section 24 of the Public Utility Holding Company Act of 1935, 15 U. S. C. 79x(a)* and under 28 U. S. C. 1254(1).

*References herein to the Public Utility Holding Company Act of 1935 will be to original section numbers only.

Question Presented

Where, pursuant to orders of the Securities and Exchange Commission (Commission), entered under the Public Utility Holding Company Act of 1935,

A. Cities Service Company (Cities) and its subsidiaries have disposed of all domestic public utility holdings, and

B. Arkansas Fuel Oil Corporation (Fuel Oil), a Cities subsidiary, was reorganized to dispose of its utility interests, simplify its corporate structure and redistribute its voting power, as required by Section 11 of the Act,

do business relations (unchanged since the reorganization) between Fuel Oil and another oil company subsidiary of Cities make the existence of a publicly-held minority interest in Fuel Oil a violation of Section 11(b)(2) of the Act so as to permit the Commission to deny Cities an exemption from regulation under the Act until that minority interest in Fuel Oil is eliminated?

Statute Involved

The relevant sections of the Public Utility Holding Company Act of 1935, 49 Stat. 803, 15 U. S. C. § 79 *et seq.*, are Sections 2(a), 3(a) and 11(b), pertinent portions of which are set forth at Appendix 71a–72a.

STATEMENT

The judgment of which review is sought affirmed an order (Order) of the Commission, made August 31, 1956. The Commission had denied Cities exemption from further regulation under the Public Utility Holding Company Act

of 1935, 49 Stat. 803, 15 U. S. C. 79-79z (Act) and had indicated that Cities would have to eliminate a publicly-held minority interest in Fuel Oil, an oil company subsidiary of Cities.

Review of the Commission order was initiated by a petition filed by Cities pursuant to Section 24(a) of the Act.

A. Background of the Order

In 1935, Cities, although engaged primarily in the oil business, controlled substantial public utility interests. Accordingly, Cities was a "holding company" as defined in the Act (Section 2(a)(7)(A)) and was required to register with the Commission (Section 5(a)).

Thereafter, following various proceedings held before the Commission, Cities disposed of all its domestic public utility interests, in order that it might retain intact its oil subsidiary interests. *Cities Service Company*, 17 S. E. C. 5 (1944).*

At the time Cities registered under the Act, one of its subsidiaries was Arkansas Natural Gas Corporation (Arknat). The principal assets of Arknat were all the voting securities of two subsidiaries, Arkansas Louisiana Gas Company (Arkla), a gas utility company, and Arkansas Fuel Oil Company (Arkco), a non-utility oil company. Because of its ownership of the stock of Arkla, Arknat was a "holding company" under the Act (Section 2(a)(7)(A)), and it registered with the Commission as such. A majority of the stock of Arknat was owned by Cities and the remaining stock was publicly-held.

In October 1952, the Commission approved a plan (Plan) to bring Arknat into compliance with Section

*In compliance with Commission orders, Cities has disposed of securities or assets valued at approximately $184,500,000.

11(b)(2) of the Act by eliminating Arknat as a sub-holding company, simplifying its capital structure and correcting allegedly unfair distribution of its voting power and, also, to dispose of Arkla, the gas utility company (thereby effectuating compliance by Arknat with the 1944 Commission order under Section 11(b)(1) [17 S. E. C. 5]). The Plan provided for

(i) the distribution of the stock of Arkla, the gas utility, to the stockholders of Arknat;

(ii) the merger of Arkco, the oil subsidiary, into Arknat, with change of the Arknat name to Fuel Oil; and

(iii) the retirement of Arknat's preferred stock and reclassification of its two classes of common stock (voting and non-voting) into a single class of Fuel Oil voting common stock and distribution thereof in exchange for Arknat's outstanding shares. (App. 67a–70a; R. 45a–48a)

Because of its ownership of Arknat stock, Cities received 51.5% of the new common stock of Fuel Oil (which it retained) and a like percentage of the stock of Arkla, the gas utility subsidiary, which, in compliance with the 1944 Commission order, Cities sold.

At the hearings on the Plan, a committee representing certain stockholders of Arknat objected that the Plan did not accord a large enough distribution of Fuel Oil stock to the public holders of Arknat stock, or, as the Commission stated in its Findings and Opinion approving the Plan, to the failure of the Plan to make provision for eliminating the minority public interest. The attention of the Commission was directed to a so-called "hypothetical refinery" contract between Fuel Oil and another subsidiary of Cities.

That contract was part of a long-standing arrangement (since 1945) under which the other subsidiary refined crude oil, sold and delivered to it by Fuel Oil, and sold to Fuel Oil refined petroleum products. Although it was contended that numerous intercorporate claims existed, no such claims were found to have arisen under the aforesaid arrangement or any other continuing intercompany business dealings or relationships. The Commission did not hold that the Committee's objection affected the merits of the Plan as an appropriate means of effecuating compliance with the provisions of Section 11(b)(2) of the Act. Instead, in its Findings and Opinion approving the Plan the Commission stated:

> "We recognize that the continued existence of a minority interest in Fuel Oil presents a problem which may require corrective action. However, in view of the fact that Fuel Oil will remain under our jurisdiction as long as Cities is a registered holding company (a status which will continue until terminated by us), we believe that consideration of the problem may be deferred until a later date." (App. 58a–59a; R. 37a)

And in its order approving the Plan, the Commission reserved jurisdiction over:

> "The resolution of the problems presented by the continued existence of a minority public interest in Fuel Oil after the consummation of the plan." (App. 68a; R. 46a)

There was no suggestion, however, that the existence of the minority might not be sanctioned by Section 11(b)(2). Such a question would have gone to the very essence of the issue then before the Commission, *i.e.*, whether the Plan would effectuate the result required by Section 11(b)(2). Indeed, the minority interest in Fuel Oil was

created by the Plan which also provided for an elaborate and costly distribution of the new stock of Fuel Oil to approximately 20,000 public shareholders.*

On January 29, 1955, Cities filed an application under Section 3(a)(5) of the Act, seeking exemption from provisions of the Act (R. 1B, Doc. 1). The Commission consolidated the exemption proceeding with the earlier proceeding on the 1952 Plan (R. 1B, Doc. 2).

Following hearings, the Commission entered, on August 31, 1956, its Findings and Opinion and the Order denying exemption (App. 19a–46a, 47a; R. 1a–26a, 27a). The Findings and Opinion focus upon the "hypothetical refinery" contract. The Commission did not hold, however, that the contract was unfair. It did conclude, though, that any business dealings between Fuel Oil and another subsidiary of Cities raise an "inherent conflict of interest" between Cities and the public minority interest in Fuel Oil which results in an "inequitable distribution of voting power", prohibited by Section 11(b)(2).** The Commission also concluded:

> ". . . that this condition can be satisfactorily rectified only by eliminating the minority public interest in Fuel Oil or by Cities disposing of its interest in Fuel Oil." (App. 46a; R. 26a)

*The stockholders committee which had objected to the failure of the Plan to provide for elimination of the minority interest disbanded following consummation of the Plan and has never again appeared in these proceedings.

In 1953, Fuel Oil, in a proceeding to which Cities was not a party, applied to the Commission under Section 5(d) of the Act for an order terminating its status as a registered holding company. The Commission granted the application, subject to a reservation of jurisdiction over Fuel Oil as a "registered holding company" in respect of the matters over which jurisdiction was reserved in the order approving the Plan (R. 23B, Doc. 26).

**The Commission has expressly held that its

> ". . . need for taking action with respect to the public minority interest is not contingent upon a finding of spoliation or abuse." (App. 44a; R. 24a)

B. The Judgment Below

On petition for review, the Court of Appeals affirmed the Order of the Commission. It held that if a majority has concern for interests outside the company

> ". . . which *may be* adverse, there is no common interest and the minority is effectively disenfranchised--its votes are meaningless and it is at the mercy of the majority." (App. 16a; R. 128) [Emphasis added.]

Calling that possible abuse of the Fuel Oil minority an "inequitable distribution of voting power", the Court of Appeals concluded that existence of the minority interest in Fuel Oil is proscribed by Section 11(b)(2). In other words, there can be no such thing as a fair and equitable distribution of voting power among security holders if there are intra-system business dealings.

C. Elimination of the Fuel Oil Minority Has Been Ordered

On September 20, 1957, the Commission entered an order, based upon the record and proceedings in this case, requiring Cities and Fuel Oil,

> ". . . to proceed with due diligence to take appropriate action to effect the elimination of the public minority stock interest in Arkansas Fuel Oil Corporation or the disposition by Cities Service Company of its stock interest in Arkansas Fuel Oil Corporation". (H. C. A. Rel. No. 13549)

On November 8, 1957, Cities filed a petition for review of that order in the United States Court of Appeals for the Third Circuit.

REASONS FOR GRANTING THE WRIT

The decision below holds that business relations between a subsidiary and its parent (or subsidiaries thereof) make it impossible to have a distribution of voting power among security holders of such subsidiary that would not be unfair or inequitable. In such a case, *any distribution* of voting power *among* security holders in the subsidiary would be inherently inequitable. That decision will have far-reaching and drastic effects. It is in conflict with express provisions of Section 11(b)(2) of the Act. It is in conflict with decisions of this Court. It conflicts with principles, long recognized by the Congress, governing intercorporate transactions.

A. The decisions of the Commission and the Court of Appeals disregard [1] unequivocal jurisdictional limitations contained in Section 11(b)(2), [2] prior determinations of the Commission and the courts in this proceeding, and [3] a line of Commission precedents going back to inception of regulation under the Act.

1. Jurisdictional Limitations of Section 11(b)(2).

In its Opinion, the Commission held that:

> ". . . the existence of the public minority interest in Fuel Oil constitutes a complexity and results in an inequitable distribution of voting power within the meaning of Section 11(b)(2) of the Act . . . [and] . . . this condition can be satisfactorily rectified only by eliminating the public minority interest in Fuel Oil or by Cities disposing of its interest in Fuel Oil. . . ." (App. 46a; R. 26a)

The Court of Appeals, passing basic problems raised by this case, affirmed.

The validity of that decision depends upon the scope of Commission power under Section 11(b)(2) of the Act.

(a) The first sentence of Section 11(b)(2) requires the Commission

> ". . . to ensure that [1] the corporate structure or [2] continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure or unfairly or inequitably distribute voting power among security holders of such holding-company system."

Since neither the Commission nor the Court of Appeals held that the "continued existence" of Fuel Oil results in "an inequitable distribution of voting power" within the meaning of Section 11(b)(2), the only power remaining to the Commission under the first sentence of that Section is to *ensure that the corporate structure* of Fuel Oil

> ". . . does not [1] unduly or unnecessarily complicate the structure, or [2] unfairly or inequitably distribute voting power among security holders"

of the Cities system.

By refusing to acknowledge this limitation, the Commission and the Court of Appeals grievously err. In disregard of Section 11(b)(2), they urge that the Commission shall regulate every circumstance that may have any effect on voting power, whether or not it complicates structure or changes the distribution of voting power. Indeed, as the Court of Appeals put it, Section 11(b)(2)

> ". . . is concerned with an undesirable effect, regardless of its cause." (App. 15a; R. 128)

But the Act by its very terms limits Commission inquiry to effects produced by only two causes. Both Section 11(b)(2) and its legislative history make patent that the

Commission may act if, (and *only* if) it is the [1] corporate structure or [2] continued existence of a company that complicates system structure or inequitably distributes system voting power.

To read Section 11(b)(2) as do the Commission and the Court of Appeals makes meaningless all reference in that Section to either "corporate structure" or "continued existence".

If the position of the Commission and the Court of Appeals is correct, then Section 11(b)(2) has been judicially amended to read:

> (2) to require by order, . . . that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that *anything regardless of its cause, relating to* any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among the security holders, of such holding-company system.

Clearly, if Congress had intended Commission power to be as broad as the Commission and the Court of Appeals assert, it would have used language such as appears above. Inclusion of the limiting terms "continued existence" and "corporate structure" rebuts any inference that such a broad grant of power was intended.

(b) Even if it be presumed that the shareholders of a company are an aspect of its "corporate structure", the Commission may not order elimination, under Section 11(b)(2), of a class of shareholders in such a company as Fuel Oil. That action would necessarily amount to a change in the corporate structure of Fuel Oil, and the Commission may not order such change by reason of the third sentence of Section 11(b)(2).

The third sentence of Section 11(b)(2), described by the Joint House-Senate Conference Committee* as "another relaxation" of the power granted the Commission under the first sentence of Section 11(b)(2), provides:

> "Except for the purpose of fairly and equitably distributing voting power among the security holders of *such company*,
>
> [*Note:* Not among security holders of "such holding-company system", as in the first sentence of Section 11(b)(2).]
>
> nothing in this paragraph shall authorize the Commission to require any change in the *corporate structure* or *existence* of any company which is *not a holding company*. . . ."

Fuel Oil is not a holding company.** There is nothing wrong with the Fuel Oil corporate structure. Indeed, that corporate structure was created pursuant to Commission order. But the Commission now claims that the Fuel Oil corporate structure results in a system inequity. In this connection, the Commission complained to the Court of Appeals that:

> ". . . Cities and Fuel Oil focus their attention exclusively on the individual companies and ignore the consequences on the holding-company system overall" (Com. Br. 32).

But elimination of the Fuel Oil minority interests may not be justified by focusing on "the holding-company sys-

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*Analysis of Title I of Public Utility Bill, Hearings Before House Committee of Interstate Commerce on H. R. 5423, 74th Cong., 1st Sess. (1935), p. 321 at 333.

**In determining the extent of the limitation of the third sentence, attention must be paid to the distinction in the Act between a "*holding company*" referred to in the third sentence and a "*registered holding company*" referred to in the first sentence. Those terms are defined in Sections 2(a)(7) and 2(a)(12) of the Act (App. 71a).

As already noted (p. 9, *supra*), the status of Fuel Oil as a "holding company" and as a "registered holding company" was terminated in 1953, but the Commission then purported to retain jurisdiction over Fuel Oil as a "registered holding company", solely for purposes of these proceedings.

tem overall". The last sentence of Section 11(b)(2) bars change in the corporate structure of a company which is not a holding company, except change for one purpose, *viz.*, to fairly distribute voting power among security holders of *such company*—not among the security holders of the system of which such company is a part.*

Petitioner does not contend, of course, that the carefully reticulated scheme of regulation contained in the Act leaves the Commission without power to protect minority interests. Under Sections 12 and 13 of the Act, the Commission may regulate all business dealings, including contractual dealings, between or among a holding company and any of its subsidiaries.** As noted in the Commission opinion, the contract to which the Commission objects (without

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*Commission refusal to recognize the limitation imposed by the third sentence was made apparent in its brief to the Court of Appeals: "The very breadth of the statute denies the argument advanced by [Cities and Fuel Oil] that although the common stockholders . . . security interest complicates the holding company structure, Congress, nevertheless precluded the Commission from taking any remedial action" (Comm. Br. 32-33). The Commission leaves unanswered the obvious question as to why Congress enacted the third sentence which, as indicated, was explained by the Conference Committee as "another relaxation" of the Senate bill which had empowered the Commission to alter the structure of *any* company in the holding-company system.

**Section 12(f) provides in substance that it is unlawful for any registered holding company or subsidiary company thereof to negotiate, enter into, or take any step in the performance of any transaction with any company in the same holding-company system in contravention of such rules, regulations or orders as the Commission deems appropriate in the public interest, for the protection of investors or to prevent the circumvention of the provisions of the Act. Section 13(b) is almost identical with respect to contracts for service, sales and construction.

Even if it were true, as the Commission apparently contends, that the intra-system business dealings of Fuel Oil are an attempt by Cities to circumvent Section 11(b)(2), corrective action by the Commission is required by Sections 12 and 13, not by the provisions of Section 11(b)(2).

Finally, if Cities is granted an exemption under Section 3(a)(5) and it thereafter overreaches in its dealings with Fuel Oil, the Commission may, under Section 3(c), revoke the exemption and reapply to Cities and to Fuel Oil the full regulatory impact of Sections 12 and 13. See, *e.g.*, *Electric Bond & Share Company*, H. C. A. Rel. No. 11675 (1953), discussed, pp. 15-17, *infra*.

finding such contract unfair), has been in existence and known to the Commission for many years and the Commission never has so much as intimated that the contract in any way violates Sections 12 or 13, or Commission rules prescribed thereunder.

Certainly where, as here, two sections of a statute are addressed specifically to regulation of intra-system business dealings, it is a gross distortion of the statutory scheme to affect such dealings by use of a third section that relates exclusively to the "corporate structure" or "continued existence of any company in the system. Yet by invoking Section 11(b)(2), and by ignoring Sections 12 and 13 of the Act, the Commission and the Court of Appeals have in this case done exactly that.

2. The Decisions Below Reverse Commission and Court Findings and Determinations in the Prior Section 11 Reorganization of Fuel Oil.

The Commission, in approving the Plan, created the very distribution of voting power in Fuel Oil which is now held to be unfair and inequitable. In creating that pattern of distribution, the Commission specifically held that the Plan would simplify corporate structure and would remedy unfair and inequitable distribution of voting power, as required by Section 11(b)(2).* Yet, in the instant pro-

*In approving the Plan, the Commission stated:

"Arknat's Class A stock represents approximately 46% of the combined common and Class A equity of the company, and the public holdings of Class A stock alone amount to 35% of the combined equity, but, as previously noted, the Class A stock has no voting power. *This situation constitutes an unfair and inequitable distribution of voting power in direct conflict with the standards of Section 11(b)(2) of the Act. The plan will remedy this condition* because it proposes to eliminate the common and Class A stocks by exchanging them for common stocks of Fuel Oil and Arkla with full voting privileges.

"In addition, the plan will simplify the corporate structure of the system. . . . Arknat, through merger with its operating oil subsidiary, will be eliminated as a holding company." (App. 54a-55a, R. 34a.) [Emphasis added.]

ceeding, the same distribution of voting power and corporate structure which it created are held by the Commission to violate Section 11(b)(2).

Since 1952, no new factor or change of circumstance has intervened. The very same intercompany dealings that are now held to present an inherent conflict of interest, existed long prior to, and were fully disclosed in, the reorganization proceedings.

The Commission has done here exactly what this Court in *Mine Workers* v. *Eagle-Picher Co.*, 325 U. S. 335, held that an administrative body has no power to do—exercise its admittedly wide discretion a second time in disregard of its previous order to which legal sanction had been imparted by court order.

After approving the Plan, the Commission obtained a court order of enforcement* requiring distribution of nearly 2,000,000 shares of Fuel Oil stock to the more than 20,000 holders of Arknat stock, thus creating the present minority interest in Fuel Oil. If Cities is to retain its oil system intact, that vast and costly process of distribution must now be reversed and all of the stock acquired from this large group of stockholders.

Had the Commission in 1952 regarded the failure of the Plan to eliminate the public minority interest in Fuel Oil as a failure to effectuate the distribution of voting power required by Section 11(b)(2), it would have been forced to recognize that such failure left unresolved the critical issue for which the hearings had been convened.

The business relations between Fuel Oil and the Cities system were, at the time the Commission approved the plan, indentical with the dealings that are going on today. But the Commission now contends that the mere juxtaposition of those dealings with the minority interest in Fuel Oil

Arkansas Natural Gas Corp., 109 F. Supp. 522 (D. Del.); affirmed, 204 F. 2d, 797 (3d Cir.), cert. denied, 346 U. S. 865 (1953).

violates Section 11(b)(2). This is rankly arbitrary, for it was the Commission, acting with knowledge of those intra-system business dealings, which sanctioned creation of the minority interest, at great expense to both Cities and Fuel Oil.

The Commission may not now use a reservation of jurisdiction, unrelated to Section 11(b)(2), to mask complete reversal of action that it long ago approved.

3. The Decision Below Conflicts With Many Prior Precedents of the Commission.

In the last 22 years the Commission has entertained and granted scores of applications for exemptions under Section 3(a) of the Act. A large number of the applicants had subsidiaries (both utility and non-utility) with outstanding public minority interests. In not one of those cases, many of which were decided by Commissioners who actively participated in the drafting of the Act, did the Commission even suggest that the presence of such minority interests was in conflict with Section 11(b)(2) or any other section of the Act.*

*In only a few of those decisions did the Commission comment upon the existence of a public minority interest in a subsidiary of the applicant. It is necessary, therefore, to go to the record in every other proceeding, or to some published source, such as *Moody's Manuals*, to determine the consistency with which the Commission heretofore has declined to regard a publicly held minority as being a material factor in an exemption proceeding.

Connecticut Power Co., 1 S. E. C. 200 (1936); Moody's Util., 1937, p. 1271; *Standard Oil of Indiana*, 11 C. A. Rel. No. 165 (1936); *Standard Oil and Gas Co.*, 1 S. E. C. 404 (1936); Moody's Ind., 1937, p. 2435; *Union Pacific R.R.*, 1 S. E. C. 441 (1936); Moody's Railroads, 1937, p. 843; *Northern States Power Co.*, 1 S. E. C. 524 (1936); Moody's Util., 1937, p. 452; *Monarch Mills*, 1 S. E. C. 822 (1936); Moody's Ind., 1937, p. 2366; *American Allied Products Co.*, 1 S. E. C. 870 (1936); *Consolidated Oil Corp.* [Now Sinclair Oil Corp.], 2 S. E. C. 165 (1937); Moody's Ind., 1838, p. 767; *Youngstown Sheet and Tube Co.*, 2 S. E. C. 873 (1937); Moody's Ind., 1937, p. 1709; *Kennecott Copper Corp.*, 3 S. E. C. 241 (1938); Moody's Ind., 1939, p. 2976; *Hudson Oil*

For example, the decision below is directly contrary to the result reached by the Commission in *Electric Bond & Share Company*, P. U. C. A. Rel. No. 11675 (1953). That case involved, among other things, an application by Bond & Share for exemption under Section 3(a)(5) of the Act. In the course of the proceedings, the Commission inquired into the relationships of Bond & Share to its subsidiary public utility holding company, American & Foreign Power. The latter company shortly before was reorganized under Section 11(e) of the Act and, as was the case in the reorganization of Fuel Oil, a large public minority interest emerged as a result of the plan, the majority of the stock of the reorganized company being held by Bond & Share. In later proceedings for exemption the existence of the large public minority interest was held to be no bar to exemption for the parent company. The Commission said:

> "The plan of Foreign Power which we have approved seeks by charter provisions to protect the public minority interest by requiring a certain percentage of the public stockholders' votes in order to take affirmative action with respect to certain vital corporate matters. These charter provisions are designed to prevent exploitation by the majority stockholders and disenfranchisement of the minority.

Corporation, 3 S. E. C. 457 (1938); Moody's Ind., 1939, p. 334; *Standard Oil Company of California*, 4 S. E. C. 826 (1939); Moody's Ind., 1940, p. 2751; *Pacific Gas & Electric Co.*, 10 S. E. C. 39 (1941); Moody's Util., 1942, p. 801; *International Utilities Corp.*, 21 S. E. C. 283 (1945); *Mead Corp.*, 11 C. A. Rel. No. 6367 (1964); Moody's Ind., 1937, p. 2857; *Texas Utilities Co.*, 31 S. E. C. 376 (1950); Moody's Util., 1951, p. 1280; *Northern States Power Co.*, 11 C. A. Rel. No. 12055 (1954); *Baltimore Gas & Electric Co.*, 11 C. A. Rel. No. 13080 (1956); *Ford Motor Co.*, 11 C. A. Rel. Nos. 13301 and 13314 (1956), and see *Eastern Gas & Fuel Associates*, 30 S. E. C. 834 (1950), where the Commission approved a plan submitted to comply with Section 11(b)(2), which plan made *no change* in minority interests in certain non-utility subsidiaries. After consummation of the plan the Commission granted Eastern's application for exemption without mention of the minority interests (11 C. A. Rel. No. 12807 (1955)). See also *Standard Oil Company (New Jersey)*, 15 S. E. C. 373 (1944).

[*N. B.*: The Commission was here changing the "corporate structure" of Foreign Power in order to ensure a fair distribution of voting power within that company.]

". . .

"Under these circumstances, we are of the view that the continuation by Bond and Share over Foreign Power is not prejudicial or detrimental to the interests of investors of Foreign Power or of Bond and Share, and, therefore, believe that Bond and Share could enjoy the same status with respect to an exemption from the Act under Section 3(a)(5) as would Foreign Power." [H. C. A. Rel. No. 11675, at p. 19]

In that case, the Commission saw no bar to exemption even though (a) there existed a 45% minority interest in a subsidiary of a registered holding company; (b) the minority interest existed in a company which was itself a registered holding company; (c) the registered holding company subsidiary held minority interests in other public utility subsidiaries; and (d) the minority stockholders in the registered holding company subsidiary were deprived, over their objection, of cumulative voting (a right granted and exercised fully by the Fuel Oil minority).*

Another case remarkably similar on its facts, but not its result, to the instant case is *Standard Oil Company (New Jersey)*, 15 S. E. C. 373 (1944). There the Commission terminated the status of Standard Oil (New Jersey) as a "registered holding company" as soon as Standard had disposed (as has Cities) of its utility interests. The Commission order contained no conditions respecting minority interests in subsidiaries, notwithstanding that there were substantial public minority interests outstanding in several large oil company subsidiaries, the principal two being

*For enforcement proceedings of the American & Foreign Power Co. plan, see *In re American & Foreign Power Co.*, 80 F. Supp. 514, 534 (D. Maine 1948); 102 F. Supp. 331, 336 (D. Maine 1951).

Humble Oil & Refining Company and Creole Petroleum Corporation. Moreover, at the time exemption was granted Standard, an action was pending in the New York Supreme Court in which a minority stockholder of Creole charged that Standard had dominated and controlled Creole to its detriment and financial loss. See *Price* v. *Standard Oil Co.*, 55 N. Y. S. 2d 890 (1945).

The impact of the long line of Commission precedents contrary to the instant case cannot be avoided, as the Commission sought to do in its Opinion (App. 32-33a; R. 12a-14a) by reference to a few Commission decisions approving *voluntary* plans submitted under Section 11(e), decisions dealing with the elimination of minority interests in subsidiary public utility companies with "integrated public utility systems." (See Section 11(b) (1)). Never in its long administration of the Act, has the Commission forced the elimination of a publicly-held minority interest against the desires of management.*

B. The decisions below [1] will affect substantially all registered public utility holding companies, [2] are contrary to decisions of this Court, and [3] conflict with principles, long established by the Congress, governing intercorporate transactions.

The vice of the decisions below rests in the premise that business dealing, however fair, between a corporation and

*The lack of precedent for Commission action was candidly conceded in the brief which the Commission Staff filed in the proceedings before the Commission:

> "[I]n no case, absent a commitment to effect such an elimination, has the Commission ever entered an order under Section 11(b) mandatorily requiring it [the elimination of a minority interest] against the desires of management where the existence of the minority interest and the related business relationship problems have been the sole basis for action under Section 11(b)." (Reply Brief of Division of Corporate Regulation of the Securities and Exchange Commission, dated December 1, 1955; Dock. No. 31, p. 9).

the owner of a majority of its stock raises an "inherent conflict of interest", leaving the minority "effectively disenfranchised".

1. Public Utility Holding Companies Affected by the Decisions.

The decisions below have direct effect upon 14 of the 25 presently registered public utility holding companies.* Moreover, if its duty is to eliminate minority interests under the rule enunciated in this case, the Commission must now revoke, under Section 3(c) of the Act, exemptions heretofore granted the many companies listed in the footnote at page 15, *supra*. The Commission will have to order those companies, as it has ordered Cities, to eliminate the minority interests which exist in their subsidiaries—to do otherwise would arbitrarily discriminate against Cities. The supposed danger to the minority interest in Fuel Oil is certainly no greater than that existing in any of those other companies.

2. The Decisions Below Conflict with Decisions of this Court.

This Court, in *Comstock v. Group of Investors*, 335 U. S. 211, a proceeding under Section 77 of the Bankruptcy Act, held that domination of a subsidiary by its parent is

> "... a relationship between corporations which the law has not seen fit to proscribe." (335 U. S. at 229)

---

*Of the 25 presently registered holding companies, 10 have subsidiaries with outstanding minority interests in the common stock of such subsidiaries. If preferred stock is considered a part of the ownership of subsidiary corporations (which the Commission has held it to be), four more of the registered holding companies must be included as directly affected by this decision.

There, a parent company had exercised control over a subsidiary through majority stock ownership. This Court held that

> ". . . mere existence of an opportunity to do wrong"

through majority control of a subsidiary is not inequitable, rather

> ". . . it is the unconscionable use of the opportunity afforded by the domination to advantage itself at the injury of the subsidiary"

that makes such domination unfair.

In the *Comstock* case, as here, the relationships between the parent and the subsidiary were

> ". . . the outgrowth of complicated, but legitimate good faith business transactions, neither in design or effect producing injury [to the minority]." (335 U. S. at 229).

The *Comstock* case has direct application to proceedings under Section 11 of the Act.* This was recognized in *In re American & Foreign Power Co.*, 80 F. Supp. 514 (D. Maine, 1948) where the court observed:

> "In the present case there was, undoubtedly, control of the subsidiary by the parent. As Mr. Justice Jackson has said in Comstock v. Group of Investors, 335 U. S. 211, this is 'a relationship which the law has not seen fit to proscribe.'" (80 F. Supp. at 530).

---

*Compare Section 11(e) of the Act (a plan must be "fair and equitable to the persons affected by such plan") with Sections 77(c) and (e) of the Bankruptcy Act, 11 U. S. C. § 205 (the Interstate Commerce Commission and the District Court must find that a plan of reorganization is "fair and equitable, affords due recognition to the rights of each class of . . . stockholders, [and] does not discriminate unfairly in favor of any class of . . . stockholders.") and Chapter X of the Bankruptcy Act, 11 U. S. C. § 621 (a plan must be "fair and equitable, and feasible").

As already noted (pp. 16-17, *supra*) the facts in the *Electric Bond & Share Company* case and in the instant case are so remarkably similar as to require like disposition of the cases.

In *Schwabacher* v. *United States*, 334 U. S. 182, this Court reviewed an order of the Interstate Commerce Commission, approving the merger of the Chesapeake & Ohio Railway Company and Pere Marquette Railway Company, subsidiaries of Alleghany Corporation. The ICC order, while approving perpetuation of a minority interest in the merged company, had left dissatisfied minority stockholders the right to eliminate themselves by appraisal proceedings. This Court held that even voluntary elimination for minority stockholders should not have been permitted by the ICC.

3. The Decision Below Conflicts with Principles, Long Recognized by Congress, Governing Intercorporate Transactions.

Although the decision below is directed against a registered public-utility holding company, the rationale of the decision has a far broader impact.

Section 5(2) of the Interstate Commerce Act (49 U. S. C. § 5(2)) was passed to regulate holding companies in the transportation field.* In administering that Act, the ICC has many times approved acquisitions, over objection by resulting minorities, of controlling stock interests in railroad corporations. See, *e.g.*, *Schwabacher* v. *United States*, 334 U. S. 182; *Benton* v. *United States*, 114 F. Supp. 37 (M. D. Ga. 1953). In the latter case, where minority stockholders sought to enjoin an acquisition of control that had been authorized by the ICC, the court pointed out that:

*See *Alleghany Corp.* v. *Breswick & Co.*, 353 U. S. 151; S. Rep. No. 87, 73d Cong., 1st Sess. p. 1.

> "... It must be kept in mind that when a person becomes a stockholder in a corporation, he assents to majority rule and impliedly agrees to abide thereby". (114 F. Supp. at 45)

The Interstate Commerce Act and the Public Utility Holding Company Act regulate holding companies, one in the transportation field, the other in the public utilities field. Common principles govern administration of those acts. The decision below is in conflict with such of those common principles as relate to the propriety of public minority interests in subsidiaries. That conflict requires examination by this Court.

CONCLUSION

The decision below raises questions of basic importance in administration of the Public Utility Holding Company Act of 1935. It is respectfully submitted that the petition for certiorari should be granted.

Respectfully submitted,

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November 8, 1957.

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JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1957

No. 602

CITIES SERVICE COMPANY,
Petitioner,

—against—

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

APPENDIX TO PETITION

BRUCE BROMLEY,
Counsel for Petitioner,
15 Broad Street,
New York 5, N. Y.

November 8, 1957

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United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 24371

In the Matter of Cities Service Company, Arkansas Fuel Oil Corporation

CITIES SERVICE COMPANY,
Petitioner,

and

ARKANSAS FUEL OIL CORPORATION,
Intervening Petitioner,

v.

SECURITIES & EXCHANGE COMMISSION,
Respondent,

and

THE PENNROAD CORPORATION, LOUIS E. MARRON, JAMES W. HEARN, ET AL.,
Intervening Respondents.

Judgment

This case having been duly heard on April 2, 1957, on the petition of Cities Service Company, petitioner, and Arkansas Fuel Oil Corporation, intervening petitioner, to review and set aside the order of the Securities & Exchange Commission, dated August 31, 1956, denying Cities Service Company's application for exemption for itself and each of its subsidiaries from the provisions of the Public Utility

Holding Company Act of 1935, and briefs and arguments of counsel having been duly considered, it is hereby

ADJUDGED, ORDERED AND DECREED that the aforesaid order of the Securities & Exchange Commission be and it hereby is affirmed for the reasons set forth in this Court's opinion herein.

By the Court:

CHARLES E. CLARK
Chief Judge

LUMBARD
Circuit Judge

Dated: August 14, 1957

Opinion

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 268—October Term, 1956.

(Argued April 2, 1957 Decided July 15, 19[illegible])

Docket No. 24371

CITIES SERVICE COMPANY,

Petitioner,

—and—

ARKANSAS FUEL OIL CORPORATION,

Intervening Petitioner,

—v.—

SECURITIES AND EXCHANGE COMMISSION,

Respondent,

—and—

THE PENNROAD CORPORATION, LOUIS E. MARRON, JAMES W. HEARN, *et al.*,

Intervening-Respondents.

Before:

CLARK, *Chief Judge,*

LUMBARD, *Circuit Judge,* and LEIBELL, *District Judge.*

Cities Service Company applied to the Securities and Exchange Commission for exemption from the Public Utility Holding Company Act of 1935, under § 3(a)(5), 15 U. S. C. A. § 79c(a)(5), on the ground that it had disposed of all its public utility interests. Finding that a publicly-held minority interest in one of Cities' subsidiaries, Arkansas Fuel Oil Corporation, constituted a complexity

which resulted in an inequitable distribution of voting power in said subsidiary, under § 11(b)(2) of the Act, and presented a potential conflict of interests between Cities and the other stockholders of Fuel Oil, the Securities and Exchange Commission concluded that it would be detrimental to the interest of the investors to grant the exemption, and it denied the application. On a petition to this Court, under § 79x(a) of the Act, to review the order of the Securities and Exchange Commission entered August 31, 1956, the order is affirmed.

CRAVATH, SWAINE & MOORE, New York, N. Y. (Bruce Bromley and Richard deY. Manning, of counsel), and Joseph L. Weiner, New York, N. Y., *for Cities Service Company, petitioner.*

DAVIS POLK WARDWELL SUNDERLAND & KIENDL, New York, N. Y. (S. Hazard Gillespie, Jr., H. C. Walker, Jr., Parker Bailey and Robert B. Fiske, Jr., of counsel), *for Arkansas Fuel Oil Corporation, intervening petitioner.*

THOMAS G. MEEKER, General Counsel, Joseph B. Levin, Assistant General Counsel, Solomon Freedman, Assistant Director, Division of Corporate Regulation, Stuart C. Law and Louis E. Clevenger, Attorneys, *for Securities and Exchange Commission, respondent.*

PERCIVAL E. JACKSON, New York, N. Y., *for the Pennroad Corporation and Louis E. Marron, intervening respondents.*

BURNS, CURRIE, RICH, MALONEY & RICE, New York, N. Y. (John J. Burns, Harold B. Dondis and Walter L. Landergan, Jr., of counsel), *for James W. Hearn et al., intervening respondents.*

HENRY A. BERGSTROM and WELLER, WICKS & WALLACE, Pittsburgh, Penna., *for M. L. Benedum, amici curiae.*

LUMBARD, *Circuit Judge*:

The basic issue in this case is whether Cities Service Company and its subsidiaries can be denied exemption from registration under the Public Utility Holding Company Act, 15 U. S. C. A. § 79, because of a publicly-held minority interest in one of Cities Service's subsidiaries, Arkansas Fuel Oil Corporation ("Fuel Oil"), even though Cities Service and all its subsidiaries have disposed of all their utility holdings. The denial was based, in part, on a prior proceeding involving Fuel Oil in which jurisdiction was specifically retained over that company as a "registered holding company," because of the publicly-held minority interest. We hold that the order of the Securities and Exchange Commission is correct in law, and supported by substantial evidence.

In 1941 Cities Service registered under the Act as a holding company within the meaning of § 2(a)(7) of the Act, 15 U. S. C. A. § 79b(a)(7)—a company which directly or indirectly owns or controls 10% or more of the voting securities of a public utility company. At the time it controlled more than 125 companies, both utility and non-utility. One of its subsidiaries was Arkansas Natural Gas Corporation ("Arknat"), the predecessor of Fuel Oil, which was itself a registered holding company with two subsidiaries—one a gas utility company, and the other a non-utility. In 1944 the Securities and Exchange Commission ordered Cities Service to limit its operations to those of a single integrated gas utility system under § 11(b)(1) of the Act, 15 U. S. C. A. § 79k(b)(1), and at Cities' request, it allowed Cities the alternative of disposing of all its

utility interests and to remain purely an oil company retaining the rest of its system intact. 17 S. E. C. 5 (1944). Cities chose the latter course. This required Cities' subsidiary, Arknat, to dispose of its interest in its gas utility subsidiary.

In 1951 Arknat filed, and the Commission approved, a reorganization plan which was designed to eliminate its utility interest, thereby terminating Arknat's holding company status, and to clear up voting and other inequities, pursuant to § 11(b)(2) of the Act.[1] As a result, Arknat gave up its interest in its utility subsidiary and merged with its oil subsidiary, the Arkansas Fuel Oil Corporation (Fuel Oil). This left a publicly-held minority interest in Fuel Oil[2] and the Commission noted that this raised problems, the solution of which would however be postponed. In its discussion of whether the plan was "necessary to effectuate the provisions of § 11(b)(2) of the Act, the Commission stated:

> "We recognize that the continued existence of a minority interest in Fuel Oil presents a problem

---

[1]Section 11(b)(2) of the Act provides, in part:

> "It shall be the duty of the Commission, as soon as practicable after January 1, 1938
>
> * * * (2) to require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. * * * Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company. * * *"

[2]Cities Service received 51.5% of the stock and the other shareholders received the other 48.5%. As of December 3, 1954 there were 20,552 shareholders in Fuel Oil.

which may require corrective action. However, in view of the fact that *Fuel Oil will remain under our jurisdiction as long as Cities is a registered holding company (a status which will continue until terminated by us)*, we believe that consideration of this problem may be deferred until a later date.

In the interim, provision should be made to give the public minority stockholders adequate representation on the initial board of directors of Fuel Oil, and accordingly prior to consummation of the plan Arknat should submit to us the names of the proposed directors for such action as we may deem proper.

In view of the foregoing, we find, that *subject to the reservations noted*, the plan provides an appropriate means for achieving the results required by Section 11(b)." [Emphasis added.] Holding Company Act Release No. 11511 (1952).

In its order of October 1, 1952, approving the plan the Commission expressly stated:

"Jurisdiction * * * is further specifically reserved with respect to * * * c. The resolution of the problems presented by the continued existence of a minority public interest in Fuel Oil after consummation of the plan; * * *"

In 1953 Fuel Oil applied to the Commission under § 5(d) of the Act for an order declaring that Fuel Oil was no longer a holding company. The Commission granted the order on October 7, 1953, but subject to the original reservation of jurisdiction for purposes of dealing with the minority interest problem. The order stated:

"In requesting the entry of an order, pursuant to Section 5(d) of the Act, declaring that it has ceased to be a holding company *Ark-Fuel has agreed and consented that any such order shall be without prejudice to the jurisdiction reserved by the Com-*

*mission's order dated October 1, 1952 * * * to the extent that the matters specified therein have not theretofore been disposed of.*

* * * * * *

The Commission finds that Ark-Fuel has ceased to be a holding company, *that it is necessary for the protection of investors that the Commission retain jurisdiction over Ark-Fuel to the same extent as though it were still in all respects a registered holding company in respect of the matters over which jurisdiction was reserved in the Commission's Order dated October 1, 1952 * * ** to the extent that the matters specified therein have not heretofore been disposed of, and that *except for such retained jurisdiction*, the registration of Ark-Fuel as a holding company should cease to be in effect." [Emphasis added.]

By 1955 Cities had disposed of all its utility holdings with one exception not relevant here. On January 29, 1955 Cities applied for exemption for itself and each of its subsidiaries from the provisions of the Act under § 3(a)(5) which provides:

"(a) The Commission * * * shall exempt any holding company, and every subsidiary company thereof as such, from any provision or provisions of this title, unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers, if—

* * * * *

(5) such holding company is not, and derives no material part of its income, directly or indirectly, from any one or more subsidiary companies which are, a company or companies the principal business of which within the United States is that of a public-utility company."

In its application, Cities stated that upon grant of the exemption, the reservation of jurisdiction over Fuel Oil

would become moot. The Commission decided that the exemption application and the problem for which jurisdiction over Fuel Oil was retained involved common issues of fact and law and dealt with them together.

Cities argued before the Commission, and here, that, since it no longer had any utility interest, any violations of § 11(b)(2) which might be charged against Fuel Oil and therefore against Cities were immaterial; that neither it nor Fuel Oil was any longer a "holding company" within the meaning of the Act and hence the two companies were no longer within the Commission's jurisdiction. The Commission on the other hand held that, regardless of whether Cities and Fuel Oil still had utility interests, both remained subject to the Act and to the jurisdiction of the Commission because Cities' registration had never been terminated and the termination order as to Fuel Oil specifically reserved jurisdiction over it as a registered holding company for the purpose of dealing with the problem of the minority interest. The Commission held that § 11(b)(2) was therefore applicable to Fuel Oil and was relevant to consideration of Cities' application under the "unless and except" clause of § 3(a)(5).

The Commission then analyzed the relationships between Fuel Oil and the rest of the Cities system. It concluded that the existence of a publicly held minority interest in Fuel Oil constituted a complexity and produced an inequitable distribution of voting power, which violated § 11(b)(2) and prevented an exemption for Cities under the "unless and except" clause of § 3(a)(5). According to the Commission, this could be cured only by eliminating the minority interest from the system, which could be achieved by either (1) eliminating the minority interest in Fuel Oil, or (2) Cities disposing of its interest in Fuel Oil. The exemption was therefore denied. This decision Cities and Fuel Oil seek to have reviewed on their petition to this Court.

We are confronted with two basic issues: (1) whether Cities and Fuel Oil are still subject to the Holding Company Act; (2) if they are, whether the elimination of the minority interest is required by § 11(b)(2) or any other provision of the Act.

1. *Jurisdiction over Cities and Fuel Oil.*

Jurisdiction over Cities and Fuel Oil turns on the resolution of two issues: (a) Is an exemption for Cities and its whole system required by the language of the Act, its policy, or by the Commission's decision of 1944; (b) if not required by any of these, do the reservation of jurisdiction over Fuel Oil and Cities' prior registration provide sufficient jurisdictional support, either separately or together, for the Commission's action.

a. *Automatic exemption for Cities Service.*

Cities contends that by disposing of all its utility holdings, it and its whole system automatically became entitled to exemption under § 3(a)(5), implying that compliance with the formal requirements of that section is sufficient. In support of this, Cities argues that the Commission decision approving its reorganization plan in 1944 provided that upon disposition of the utility interests Cities could "retain the rest of its system *intact*." 15 S. E. C. 962, 978, 17 S. E. C. 5, 6 (1944) [Emphasis by Cities], and it reads this to mean free from any other regulation. This reading of the decision is alleged to be in accord with statutory policy, for, it is argued, the Act was not intended to regulate companies after they had disposed of their utility interests. Thus, § 11(b)(2) applies only to companies "which are to remain in a public utility holding company system as permitted by Section 11(b)(1)."

Cities argument both misreads the act and misconstrues the 1944 Commission decision. We think that the Commis-

sion was empowered to require action in addition to disposition of all utility interests and subsequent thereto, and that its decision in 1944 was not intended to curtail these powers. We will first discuss the statute and its policy.

The language of § 3(a)(5) itself indicates that even after a system has eliminated all its domestic utility interests, regulation may continue. Thus it provides that even though "such holding company is not, and derives no material part of its income, directly or indirectly, from any one or more subsidiary companies, which are, a company or companies the principal business of which within the United States is that of a public-utility company;" the Commission may still deny an exemption if it finds "the exemption detrimental to the public interest or the interest of investors or consumers." This clause clearly implies that regulation of registered holding company systems may go beyond requiring elimination of the utility interests at both the initial and later stages of regulation. See also, *In re United Corporation*, 232 F. 2d 601 (3 Cir.), cert. den. 352 U. S. 839 (1956).

The policy underlying this is equally clear, and is not as limited as Cities contends. "Although one of the purposes of the Act was the elimination of holding companies, another purpose was the elimination of evils which had become part of the corporate structure of registered holding companies and their subsidiaries * * *" *In re United Corporation*, 232 F. 2d at 606. This policy would be frustrated if companies which were required to register and to be subject to Commission regulation, were to be released from such regulation before the various evils were rectified.

Nor does anything in the legislative history support Cities' contention. Although it is true that much of it is couched in terms of regulation of public utilities, and of eliminating the evils in such systems, the crucial question before us is whether regulation by the Commission must

stop at requiring elimination of the utility interests. As to this, whatever legislative history there is, is to the contrary. Thus, the Report of the National Public Power Policy Committee stated: "Such legislation should *eradicate disclosed abuses,* * * * *and* make possible the elimination of the holding company where it serves no demonstrably useful or necessary purpose." H. R. Rep. No. 137, 74th Cong. 1st Sess. 8 (1935) [Emphasis added].[3]

That the utility interests are disposed of before all the abuses have been eliminated does not deprive the Commission of power to deal with the abuses even though it chooses to do so after the divestiture. We therefore hold that once a company registers under the Act as did Cities Service, the Commission may take all necessary and proper steps to "eradicate disclosed abuses" in addition to elimination of utility interests leading to eventual exemption.

In light of this discussion of the statute and its policy, Cities' construction of the 1944 decision is not persuasive. Moreover, that decision dealt exclusively with Cities' compliance with § 11(b)(1), which relates to geographical integration. By allowing the rest of the system to remain "intact," the Commission meant only that if Cities were to dispose of all its gas distribution properties, it could retain all its other businesses.[4] Problems related to § 11(b)(2) were not even remotely involved.

---

[3]Indeed, the abuses within the Cities system were among the main causes for the passage of the Holding Company Act. See Cities Service Company, 8 S. E. C. 318, 335-37, 340-359 (1940).

[4]"* * * our order does not foreclose retention in the Cities Service system of all of its oil business, all of its gas production and transmission business, and all of its other nonutility holdings, if Cities should choose to comply with Section 11(b)(1) by disposing of its holdings in all utility companies. In designating the Mid-Continent [gas] distribution properties as the single retainable system we do not require retention of this system. Cities may choose to dispose of its utility holdings and retain the rest of the system intact." 15 S. E. C. 962, 978 (1944).

We therefore hold that neither compliance with the formal requirements of § 3(a)(5), nor the Commission's decision in 1944 requires exemption for Cities and its system.

b. *Jurisdictional support for the Commission's action.*

Cities and Fuel Oil contend, however, that even if the Cities system is not entitled to exemption by meeting the formal requirements of § 3(a)(5), the 1952 plan which resulted in Fuel Oil was intended to meet all the requirements of § 11(b)(2) and that the 1953 order terminating Fuel Oil's status as a holding company confirmed this. Hence, the Commission could not require elimination of the minority interest in order to satisfy § 11(b)(2).[5]

We reject the petitioners' contention that the plan approved in 1952 was intended to constitute full compliance with all the requirements of § 11(b)(2). The Commission's language approving the plan, *supra*, p. 1911, shows that it considered that more still needed to be done and that, as it said, "consideration of this problem [the continued existence of a minority interest] may be deferred until a later date." The reservation of jurisdiction in the opinion and order was intended for the specific purpose of dealing with the problem of the minority interest at a later time.

Cities and Fuel Oil claim, however, that this retention of jurisdiction is not broad enough to support the Commission's action in this case. They first point out that the various orders retained jurisdiction over Fuel Oil only as a "registered holding company," and not as a "holding company." The difference is that a "holding company" is a

[5]Because the Commission did not rely solely on § 11(b)(2) but also on the "unless and except" clause entirely apart from the requirements of § 11(b)(2), see p. 1919, n. 9, *infra*, the appellants also argue that the "unless and except" clause alone is insufficient authority for requiring the elimination of the minority interest. Since we agree with the Commission that § 11(b)(2) is applicable, we need not discuss that contention.

company which owns 10% or more of a public utility company[6] whereas a "registered holding company" is merely "a person whose registration is in effect under section 5," 15 U. S. C. A. § 79b(a)(12) and need not be a holding company, *i.e.*, with utility interests. And since the plan had required Fuel Oil's predecessor to dispose of all its utility holdings, Fuel Oil was in fact no longer a holding company. They then point out that the third sentence of § 11(b)(2)[7] prohibits the Commission from authorizing any change in the capital structure of any company not a holding company except for the purpose of correcting an inequitable distribution of voting power,[8] and they wind up their argument with the charge that the Commission erred in holding that the mere continued existence of a publicly-held minority interest could produce an inequitable distribution of voting power. They conclude that the Commission's order was outside the exception specified in the third sentence of § 11(b)(2). We find it unnecessary to pass on the soundess of petitioners' proposed distinction between a "holding company" and a "registered holding company." Petitioners' argument concedes that if the Commission's action was in order to eliminate an inequitable distribution of voting power, its action was within its jurisdiction regardless of which status Fuel Oil retained. We therefore

---

[6]Sec. 2(a)(7), 15 U. S. C. A. 79b(a)(7) provides: "'Holding company' means (A) any company which directly or indirectly owns, controls, or holds with power to vote, 10 per centum or more of the outstanding voting securities of a public-utility company or of a company which is a holding company. * * *"

[7]"Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company. * * *"

[8]If the company is a holding company, the Commission may require the elimination of complexities as well as the correction of inequitable distributions of voting power.

turn to the Commission's decision that the publicly-held minority interest produced such an inequitable distribution.[9]

c. The meaning of "inequitably distributed voting power."

Cities and Fuel Oil contend that an inequitable distribution must exist "in the particular company"—here, Fuel Oil—and not in the system as a whole. Since each shareholder in Fuel Oil has one vote for one share, they claim that the distribution cannot be inequitable within the company.

We do not agree that the one vote-one share formula precludes a finding that there is an inequitable distribution of voting power. In the first place, although the statute may refer only to an equitable distribution "in the particular company in question," it does not follow that "the Commission * * * may not correct an unfair and inequitable distribution of voting power existing *by reason of* such company's inclusion in a holding company system."[10] [Emphasis added.] The statute is concerned with an undesirable effect, regardless of its cause, and petitioners' reasoning confuses cause and effect.

As to whether there was an inequitable distribution in Fuel Oil despite the one share-one vote proportion, we think that petitioners' conception of what is equitable and fair is unrealistic. A ballot has power only when it can influence decision. Because of the majority rule principle, the voting power of a permanent minority can easily be

[9]The Commission based its decision on two other grounds as well: (1) that the existence of the minority interest constituted a complexity within the meaning of § 11(b)(2); (2) that the existence of a conflict in interest between a registered holding company and its subsidiary justified denial of the exemption under the "unless and except" clause of § 3(a)(5) entirely apart from the requirements of § 11(b)(2). Since, as will appear, we agree with the Commission that there is an inequitable distribution of voting power, we need not discuss the other two grounds.

[10]Reply Brief for Petitioner Cities Service p. 6.

annulled. One reason why the minority is willing to run this risk is the belief that by and large, differences between majority and minority are differences over means rather than ends since the majority is as eager to further the interests of the corporation as the minority. Thus, if a minority shareholder can convince the majority that a certain course is best for the corporation, he expects that the majority will concur therein, for he expects that it will consider the common corporate interest to be of paramount importance. If the majority's basic concern is not for the welfare of the particular corporation but for an interest which may be adverse, there is no common interest and the minority is effectively disenfranchised—its votes are meaningless and it is at the mercy of the majority.

Thus even within the individual company itself—Fuel Oil—if the minority has no chance to influence decision because the majority does not have single-minded allegiance to the corporation, the one share-one vote formula does not mean that the distribution of voting power is equitable. We thus come to the question of whether there is support for the Commission's finding that there is an "inherent conflict of interests which pervades all aspects of dealings between the Fuel Oil system and the Cities system * * * [and which] constitutes a detriment to the interests of the minority stockholders, who are thereby deprived [of] a management conducting Fuel Oil's affairs with an eye single to its own advantage."

2. The conflict of interest.

It is not necessary to set forth the details of the arrangement between Fuel Oil and the rest of the Cities Service system, which appear in the Commission's decision. Briefly, Fuel Oil's predecessor owned and operated a refinery at Bossier City, Louisiana. By 1938 the refinery was becoming obsolete and discussions about replacement were begun

Finally in August 1945 an engineering firm submitted numerous plans for modernization.

Despite these plans, on September 20, 1945 Fuel Oil's board of directors voted to shut down the Bossier City refinery and to contract with Cities Refinery Co., another Cities Service subsidiary, for Fuel Oil's refined products requirements. It appears that at this time Cities Refinery Co. was in need of markets. The Commission found that this was indeed part of the motive for shutting down the Bossier City plant. Fuel Oil directors, realizing that something had to be done to protect the interests of the minority shareholders, approved a contract between Cities Refinery and Fuel Oil which provided for price adjustments, the purpose of which was that Fuel Oil would pay no more for its refined products than if it had modernized its own plant in 1945.

The record shows that this "hypothetical refinery" arrangement produced many complications and conflicts of interest despite good faith efforts to keep them at a minimum. Thus, the Commission found that "the hypothetical refinery is not geared to meet either in quality or quantity the refined products requirements of Fuel Oil"; that there had been disputes as to the amount of compensatory discount Fuel Oil was to obtain from Cities Refining; and finally, that there had been disagreements as to the cost of certain improvements which were to be included in the cost calculations for the hypothetical refinery. The Commission found that there had also been many mathematical errors in computation and it concluded that the whole concept of working on the basis of a hypothetical refinery whose capacity and costs were fixed at the 1945 level was not only impractical, but it was detrimental to Fuel Oil, for it put that company on an operational basis where it could not take advantage of any improvements. The Commission further concluded that:

> "The inherent conflict of interests which pervades all aspects of dealings between the Fuel Oil system and the Cities system is such that it constitutes a detriment to the interests of the minority stockholders, who are thereby deprived of a management conducting Fuel Oil's affairs with an eye single to its own advantage."

This brief resume of the facts shows that there is ample support in fact and common sense for the conclusions of the Commission that there were inherent conflicts of interest and the *de facto* disenfranchisement of the minority interest. On this record the Commission was justified in refusing to grant exemptions to Cities until Fuel Oil eliminated the minority interest.

Since we find that the Commission still has jurisdiction over both Cities and Fuel and can require Fuel Oil to comply with § 11(b)(2) by eliminating the minority interest, and since there is substantial evidence to support its finding of an inequitable distribution of voting power, we affirm the decision and order of the Commission denying the application of Cities Service for exemption for itself and each of its subsidiaries from the provisions of the Public Utility Holding Company Act of 1935.

(Holding Company Act Release No. 13254)

Securities and Exchange Commission

WASHINGTON, D. C.

August 31, 1956

Findings and Opinion of the Commission

IN THE MATTER
of
CITIES SERVICE COMPANY
ARKANSAS FUEL CORPORATION
Files Nos. 31-622; 54-186;
59-93; and 70-1804
(Public Utility Holding Company Act of 1935)

SIMPLIFICATION OF HOLDING COMPANY SYSTEM

Undue and Unnecessary Complexity
Inequitable Distribution of Voting Power
Public Minority Interest

Held, existence of publicly held minority interest in one or more of several companies comprising an integrated holding company system constitutes an undue and unnecessary complexity which results in an inequitable distribution of voting power, and the elimination of such minority interest or the disposition by the holding company of its interest in companies having public minority stockholders is required by Section 11(b)(2) of the Act.

EXEMPTION OF HOLDING COMPANY

Exemption Denied.

Application for exemption by a holding company which has a subsidiary with a publicly held minority interest, *denied*, because under the circumstances the exemption would be detrimental to the interest of investors.

Appearances:

JOSEPH L. WEINER, and EUGENE R. SULLIVAN and EVERETT W. YOUNG, of Frueauff, Burns, Farrell, Shanley & Johnsen, for Cities Service Company.

H. C. WALKER, JR., of Blanchard, Goldstein, Walker & O'Quin, for Arkansas Fuel Oil Corporation.

EDWARD KELLY, for M. L. Benedum, a common stockholder of Arkansas Fuel Oil Corporation.

PERCIVAL E. JACKSON, THEODORE N. TARLAU, and JOSEPH J. BRYER, for Pennroad Corporation, a common stockholder of Arkansas Fuel Oil Corporation.

JOHN J. BURNS, HAROLD B. DONDIS, WALTER L. LANDERGAN, JR., of Burns, Blake & Rich, for James W. Hearn, Paul S. Hearn, William J Hearn and Eleanor Hearn, common stockholders of Arkansas Fuel Oil Corporation.

SOLOMON FREEDMAN, LOUIS E. CLEVENGER and ROBERT A. MCDOWELL, for the Division of Corporate Regulation of the Commission.

These are consolidated proceedings with respect to an application filed pursuant to Section 3(a)(5) of the Public Utility Holding Company Act of 1935 (the "Act") by Cities Service Company ("Cities"), a registered holding company, for an exemption for itself and each of its subsidiary companies from the provisions of the Act,[1] and with respect to an issue we previously reserved in proceedings under Section 11(b)(2) and 11(e) of the Act concerning the continued existence of a 48.5% publicly held common stock interest in Arkansas Fuel Oil Corporation ("Fuel Oil"), a subsidiary of Cities.[2]

After appropriate notice, hearings were held at which the companies involved, the Division of Corporate Regulation ("Division"), and stockholders of Fuel Oil appeared. At the close of the hearings, briefs and reply briefs were filed, and thereafter we heard oral argument.

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[1]Section 3(a)(5) provides:

> "The Commission, by rules and regulations upon its own motion, or by order upon application, shall exempt any holding company, and every subsidiary company thereof as such, from any provision or provisions of this title, unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers, if—
>
> > "such holding company is not, and derives no material part of its income, directly or indirectly, from any one or more subsidiary companies which are, a company or companies the principal business of which within the United States is that of a public-utility company."

[2]Section 11(b)(2) directs this Commission:

> "To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system * * *."

Section 11(e) relates to approval of plans filed by companies for compliance with the provisions of Section 11(b).

On the basis of an independent consideration of the record, we make the following findings.

I. Background of the Proceedings.

In 1944 we entered an order under Section 11(b)(1) of the Act[3] directing Cities to dispose of all of its interest, direct or indirect, in public utility companies.[4] At that time the Cities system included Arkansas Natural Gas Corporation ("Arknat"), a registered subholding company. The principal subsidiaries of this company were Arkansas Louisiana Gas Company ("Arkla"), a gas utility company, and Arkansas Fuel Oil Company ("Arkco"), a non-utility company with 10 non-utility subsidiaries. In 1952 we approved a plan under Section 11(e) of the Act which was ordered enforced in the courts and subsequently consummated.[5] The plan provided for the retirement of Arknat's preferred stock; the merger of Arkco into its parent, Arknat, with the latter's name changed to Fuel Oil; the distribution by Arknat of the common stock of its subsidiary Arkla to the holders of its common and Class A stock on the basis of one-half share of Arkla common stock for each share of common or Class A stock, with Cities subsequently disposing of the interest in Arkla it thus acquired; the conversion of both the common and Class A stock of Arknat into a new common stock of Fuel

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[3]Section 11(b)(1) requires the integration of public utility holding company systems in accordance with certain designated standards.

[4]*Cities Service Company*, 17 S. E. C. 5. This was a modification made at Cities' request of an earlier Section 11(b)(1) order, *Cities Service Company*, 15 S. E. C. 962 (1944).

[5]*Arkansas Natural Gas Corporation et al.*, Holding Company Act Release No. 11511 (October 1, 1952), approved and enforced 109 F. Supp. 522 (Dist. Del. 1953), affirmed 204 F. 2d 707 (C. A. 3, 1953), *cert den. sub nom. Public Common Stockholders Committee v. Arkansas Natural Gas Corporation et al.*, 346 U. S. 865 (1953).

Oil having a par value of $5 per share, on the basis of one-half new share for each old share outstanding, under which Cities acquired 1,958,190 shares (51.5%) of the 3,801,536 shares of reclassified common stock and public holders 1,843,346 (48.5%); and a cash payment by Cities to the public holders of Arknat's common and Class A stock of $1.50 per share of Class A stock and 25¢ per share of common stock, or an aggregate of $4,069,268.75, in full settlement of all claims that had been or might be asserted against Cities and its subsidiaries in the proceedings.[6]

In the proceedings on the plan, which had been consolidated with proceedings under Section 11(b)(2) directed to Arknat and Cities that we had instituted in 1949, a committee representing Class A stockholders raised objections to the failure of the plan to eliminate the publicly-held stock interest in Arknat. In our order approving the plan we reserved jurisdiction over "the problems presented by the continued existence of a minority public interest in Fuel Oil after consummation of the plan." In this connection we stated in our Findings and Opinion:[7]

> "We recognize that the continued existence of a minority interest in Fuel Oil presents a problem which may require corrective action. However, in view of the fact that Fuel Oil will remain under our jurisdiction as long as Cities is a registered holding company (a status which will continue until terminated by us), we believe that consideration of this problem may be deferred until a later date.
>
> "In the interim, provision should be made to give the public minority stockholders adequate representation on the initial board of directors of Fuel Oil, and accordingly prior to consummation of the plan Arknat should submit to us the names of the pro-

[6] No cash payment was made to the so-called Benedum interests who together with Cities had organized Arknat.

[7] *Arkansas Natural Gas Corporation*, Holding Company Act Release No. 11511 (October 1, 1952), at pp. 17-18.

posed directors for such action as we may deem proper.

"In view of the foregoing, we find that, subject to the reservations noted, the plan provides an appropriate means for achieving the results required by Section 11(b)." (Footnote omitted.)

Fuel Oil has eleven directors, six representing Cities and five representing the publicly-held minority interest. Of the latter five, two were originally designated by the Benedum interests, two by the former public holders of the Arknat Class A stock, and one by the former public holders of the Arknat common stock. These five directors have been re-elected each year since their original designation in 1953, except that one of the Benedum-designated directors died and was succeeded by another individual representing those interests. Fuel Oil's stockholders have cumulative voting rights.

In 1953, pursuant to an application filed under Section 5(d) of the Act, we entered an order declaring that Fuel Oil had ceased to be a holding company within the meaning of the Act.[5] Fuel Oil agreed to, and our order provided for, retention of jurisdiction over the public-minority interest question we had reserved in our order approving the Section 11(e) plan to the same extent as though Fuel Oil were a registered holding company.

Cities is engaged in oil, natural gas and other non-utility businesses and has one remaining public utility subsidiary, Dominion Natural Gas Company, which operates in Canada. This Company is subject to the 1944 divestment order, and relief therefrom is not sought by the application for exemption.

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[5] *Arkansas Fuel Oil Corporation*, Holding Company Act Release No. 12190 (October 7, 1953).

II. Description of Fuel Oil and its relations with the Cities System.

Fuel Oil has two subsidiaries, Orange State Oil Company ("Orange State") and Arkansas Pipeline Corporation ("Pipeline"). Consolidated assets of the system, per books, at December 31, 1954, totalled approximately $80,000,000, of which $49,000,000 represented net investment in property, plant and equipment, consisting largely of petroleum and natural gas production properties and equipment, pipe line properties, and retail gasoline service stations. The remaining assets consisted principally of cash items, accounts receivable, and inventories and supplies.

The Fuel Oil system is engaged in (1) the production, purchase, transportation, and sale of crude oil; (2) the production, processing, and wholesale sale of natural gas, and the sale of liquid hydrocarbons extracted from natural gas; and (3) the purchase and sale of refined petroleum products and automobile accessories through some 6,158 retail outlets carrying the Cities name in eleven southern and southeastern states. The system does not own a refinery or refine any crude oil, but prior to 1945, it did own and operate a refinery in Bossier City, Louisiana. In that year, however, those operations were shut down and since then a major portion (72% in 1954) of the crude oil produced and purchased by Fuel Oil has been sold to and refined by Cities Service Refining Corporation ("Cities Refining"), a wholly-owned subsidiary of Cities, pursuant to an arrangement, which is described more fully below, under which costs and charges are based on the hypothetical continuation of operations at the Bossier City refinery. Fuel Oil and Orange State purchase the finished petroleum products they market through their retail gasoline distribution stations largely from Cities Refining (95% in 1954).

Fuel Oil has contracts with non-affiliated companies for the manufacture of tires and tubes which bear the brand name "Cities Service", and it sells part of these tires and tubes to two wholly-owned subsidiaries of Cities on a cost-plus-1% basis. Fuel Oil participates in a research program carried on by a wholly-owned subsidiary of Cities and pays part of the operating expenses of this program, but the subsidiary conducting the program retains ownership of any and all patents developed and obtained from its operations. Fuel Oil also shares in the national advertising program conducted by Cities for its name brand products by paying part of the expense of that program. The Fuel Oil System leases from wholly-owned subsidiaries of Cities a $1,000,000 terminal at Ft. Lauderdale, Florida, several service stations, and certain pumping equipment. Ocean transportation requirements for certain petroleum products of Fuel Oil are furnished to Fuel Oil pursuant to a contract with a wholly-owned subsidiary of Cities. Fuel Oil carries on part of its oil and gas lease development, operation and ownership jointly with a wholly-owned subsidiary of Cities.

III. Position of the Participants.

Cities, Fuel Oil, and M. L. Benedum, a common stockholder and director of Fuel Oil, contend that Cities' application for exemption should be granted, that no action should be taken with respect to the public minority interest in Fuel Oil, and that no recognition should be given to certain claims asserted by the objecting common stockholders. The objecting stockholders, Pennroad Corporation and the Hearn family,[9] urge that we deny the request for exemption, that the public minority interest should be eliminated either by Cities disposing of its interest in Fuel

[9]We find no merit in Cities' contention that we should reverse the hearing examiner's ruling granting participation in the proceedings to the objecting stockholders.

Oil or acquiring the minority interest, and that Cities should make restitution to Fuel Oil for past injustices resulting from the hypothetical refinery arrangement. The Division contends that Cities' application for exemption should be permitted to become effective, but only after one of the following alternatives has been satisfied: (1) disposition by Cities of its holdings in Fuel Oil; (2) elimination of the public stock interest in Fuel Oil; (3) establishment of sales prices of refined products to Fuel Oil by Cities Refining at the latter's cost insofar as such products are deemed to be recovered from crude oil sold by Fuel Oil to Cities, with any other sales between the companies being at fair competitive market prices; or (4) elimination of the existing complexities in the relationship between the companies in a manner we find satisfactory.

IV. Applicable Statutory Standards.

Under Section 11(b)(2) of the Act we are required to direct each registered holding company and each of its subsidiary companies to take such steps as we find necessary, among other things ". . . to ensure that the corporate structure . . . of any company in the holding company system does not unduly or unnecessarily complicate the structure or unfairly or inequitably distribute voting power among security holders of such holding company system."

Cities contends that all issues under Section 11 are *res judicata* because in our Findings and Opinion approving the plan we held that the plan would achieve a fair and equitable distribution of voting power and the required corporate simplification of the Fuel Oil system.[10] Cities also

[10] We stated (Holding Company Act Release No. 11511, at p. 8):

"Arknat's Class A stock represents approximately 46% of the combined common and Class A equity of the company, and the public holdings of Class A stock alone amount to 35% of the combined equity, but, as previously noted, the

asserts that our statement with respect to reserving jurisdiction quoted above referred not to Section 11 but only to Sections 3 and 5 of the Act.[11] We do not agree with these views.

We hold that an unfair and inequitable distribution in voting power existed in the fact that the Class A stock of Arknat had no voting power, and that this would be remedied by exchanging that stock for a voting security. We expressly recognized, however, that the continued existence of the public minority interest presented a problem which might require corrective action, and the vehicle provided in the statute for directing such remedial action is Section 11(b)(2). In approving the plan we did not find that it necessarily met all the problems under Section 11; our approval was in accordance with our policy of administering Section 11 so as to permit compliance in a series of steps and not to insist on full compliance in one plan.[12]

Class A stock has no voting power. This situation constitutes an unfair and inequitable distribution of voting power in direct conflict with the standards of Section 11(b)(2) of the Act. The plan will remedy this condition because it proposed to eliminate the common and Class A stocks by exchanging them for common stocks of Fuel Oil and Arkla with full voting privileges.

"In addition, the plan will simplify the corporate structure of the system. The capitalization of each of the corporations to emerge from the reorganization will consist of debt and only one class of stock; Arknat, through merger with its operating oil subsidiary, will be eliminated as a holding company; and Arkla will sell its holdings in its only subsidiary."

[11] Section 5(d) provides that we may terminate the registration of a holding company which has ceased to be such, subject to such terms and conditions as are necessary for the protection of investors.

[12] In *Phillips v. S. E. C.*, 156 F. 2d [illegible] (C. A. 2, 1946), the court stated:

"There is nothing in the Act which says every order must be 'all or none' one and that strict compliance with the ultimate objective must be forced at once as if that were even remotely possible in view of the intricacy of these huge

This technique for achieving compliance, however, may not to be used as a means of frustrating the achievement of the objectives of Section 11.[13]

Cities, of course, is a registered holding company, as is Fuel Oil for the purpose of this proceeding, and the latter's status as a holding company was preserved, with its consent, only because of the minority interest problem. As a registered holding company it like Cities is subject to the provisions of Section 11(b)(2) and to such action as could have been appropriately directed to Arknat prior to its reorganization, which unquestionably could have included the elimination of the public minority interest. To invoke this authority would not, as Cities suggests, be expanding the statute to regulate a non-utility situation.[14] The fact that Arknat is no longer in the utility business and that Cities is no longer in the domestic utility business is a circumstance stemming from the sequence of the steps taken to comply with the statute and does not affect the extent of compliance which must be achieved. The controlling consideration is the fact that one of the specific and stated purposes of the prior proceedings was to deter-

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financial structures. Rather has it been recognized throughout that the Commission's task was a delicate one, that a principal reason for its creation was 'to secure the benefit of special knowledge acquired through continuous experience in a difficult and complicated field', in short, that the Commission should act its role of technical expert, rather than that of 'mere policeman,' restricted only to shaking his billy at possible offenders."

[13] See *In re The United Corporation*, 128 F. Supp. 725, 738 (D. Del. 1955), affirmed 232 F. 2d 601 (C. A. 3, decided April 16, 1956).

[14] *Cf. Columbia Gas & Elec. Corporation*, 12 S. E. C. 218 (1942), where in approving a Section 11(e) plan providing for the liquidation of a non-utility subsidiary we directed that in the event the liquidation was not carried out, the subsidiary should recapitalize so as to ensure that its voting powers would not be unfairly and inequitably distributed. See also *Cities Service Company*, 11 S. E. C. 975 (1942), 11 S. E. C. 943 (1942).

mine whether the corporate structure of Arknat was in violation of the standards of Section 11(b)(2), and, if so, what action should be required of it and Cities to rectify the situation. Accordingly, if the existence of the public minority interest violates the standards of Section 11(b)(2), our reservation of jurisdiction affords ample basis for directing elimination of that interest unless, as Cities contends, the interposition of Cities' request for exemption, to which we now turn, relieves the system from the necessity for compliance with Section 11(b)(2).

As has already been pointed out, Cities has one public utility subsidiary and that company operates in Canada. Therefore since neither Cities nor any of its subsidiaries is in the public utility business in the United States, Cities meets the formal conditions of Section 3(a)(5). However, this alone is not sufficient to entitle Cities to an exemption because Section 3(a) provides for exemptions "unless and except insofar as [this Commission] finds the exemption detrimental to the public interest or the interest of investors or consumers." Accordingly, although Cities meets the formal conditions of Section 3(a) we must nevertheless determine whether and to what extent such exemption may be detrimental to the public interest or the interest of investors or consumers.[15]

In considering applications for exemptions and the impact of the "unless and except clause" we have recognized, on the one hand, that in providing for general exemptions from the provisions of the Act Congress must have contemplated that exemptions would be available in situations where total compliance with Section 11 was not fully met since otherwise it would have conditioned the grant of

[15] *American & Foreign Power Company, Inc.*, 6 S. E. C. 396 (1939); *International Utilities Corporation et al.*, 9 S. E. C. 547 (1941); *Standard Oil Company*, 10 S. E. C. 1122 (1942); *Electric Bond and Share Company*, Holding Company Act Release No. 11000 (February 6, 1952).

exemptions on a finding of compliance with that section. On the other hand, we have also recognized that Congress did not provide for an unqualified and self-operative exemption where the applicant had met the formal conditions of Section 3(a)(5) but, as noted, instead empowered this Commission in the exercise of our discretion to condition or deny an exemption where it is detrimental to the public interest or the interest of investors or consumers.

In exercising this discretion, consistent with the expressed Congressional policy of not permitting exemptions which would be "definitely detrimental to the basic purposes of the statute",[16] we have considered in each case the provisions of the Act from which exemption is sought and the consequences of an exemption upon the public interest and the interest of investors or consumers as it is reflected in the statutory objectives. Thus, in *Eastern Gas and Fuel Associates*[17] we held that the "unless and except" clause "does not require the imposition of the standards of Section 11(b)(1) in determining the availability of the exemption, although system and corporate complexities or an inequitable distribution of voting power, which we are directed to remedy under Section 11(b)(2), so directly affect the interests of investors and consumers that their continued existence would require denial of . . . [the] application for exemption." Under this test, if the public minority interest in Fuel Oil does constitute a corporate complexity or results in an inequitable distribution of voting power which operates to the detriment of investors, we could not exempt Cities until it rectified the situation.

We have held repeatedly that the existence of a publicly held minority interest in the securities of one or more of

[16]Sen. Rep. No. 621, 74th Cong., 1st Sess., p. 4.

[17]30 S. E. C. 834, 848-849 (1950). See also *Northern States Power Company* (Minn.), Holding Company Act Release No. 12655 (September 16, 1954), at p. 9.

several companies comprising an integrated public utility system constitutes an undue and unnecessary complexity which in turn results in an inequitable distribution of voting power, and the elimination of such an interest is required by Section 11(b)(2).[18]

This conclusion

> ". . . is bottomed on an inherent conflict of interests as between the diverse owners which pervades all aspects of the dealings among the system companies. Major operational questions, as for instance the location of new plants, must be viewed not only in relation to operational requirements but also as to the effect on the different groups of security holders. Financing problems are likewise complicated and decisions affecting day by day dealings between the companies may be influenced by considerations extraneous to sound operation.
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> "As we have previously stated: 'integrated operation . . . assumes to a considerable degree that separate corporate entities might be called on to sacrifice their particular interests for the overall good. While this creates no problem where the entities are owned by the same group of people in the same proportion . . . it creates an insuperable difficulty where the entities . . . are owned by different groups'.
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> "If fair treatment of all groups is to be scrupulously observed many of these sacrifices must be foregone and the full benefits of integration thus

[18] *Alabama Power Company*, Holding Company Act Release No. 11548 (October 21, 1952); *The United Gas Improvement Company*, Holding Company Act Release No. 11495 (September 18, 1952); *The Southern Co.*, 31 S. E. C. 821 (1950); *Sioux City Gas and Electric Company*, 30 S. E. C. 5 (1949) approved and enforced D. C., N. D., Iowa, Civil Action No. 571 (1949). See also *Georgia Power and Light Company*, 18 S. E. C. 89 (1945), D. C., N. D. Georgia, Civil Action No. 133 (1945).

unrealized. However, our experience has disclosed that where the exigencies of the situation are sufficiently compelling the management has little choice but to make decisions in the light of the overall needs of the system, whatever the effect on the minority holders of securities. In such a situation the right to vote for directors is an illusory protection to the minority stockholders where the bulk of the voting stock is system held."[19]

Cities argues that these views relate peculiarly to integrated utility systems and have no application to the Fuel Oil system, because it is non-utility in character. While our views were stated in the context of integrated utility systems, we do not agree that they are not pertinent to the issue before us. The question is whether the factor which renders a minority interest a complexity and inequitable distribution of voting power, *i.e.*, the inherent conflicts of interests, exists by virtue of relationships between Fuel Oil and the Cities system.

Cities further argues that in no instance have we directed the elimination of a minority interest. While it is true that the cases that have come before us dealing with this problem have arisen in the context of voluntary Section 11(e) plans, it must be recognized that in all the cases the elimination of the minority interest was predicated upon the necessity of complying with the requirements of Section 11(b), and indeed in some of the cases the proceedings were consolidated ones under both Sections 11(e) and 11(b).

Apart from Section 11(b)(2) and considering the problem exclusively in terms of the "unless and except clause", we have also reached the conclusion that where there exists a potential conflict of interest between a registered holding company seeking an exemption and its subsidiaries, the

[19] *Alabama Power Company*, Holding Company Act Release No. 11548, (October 21, 1952), p. 5.

exemption will be denied. In *Electric Bond and Share Compan* Holding Company Act Release No. 11004 (February 6, 1952) at p. 43, we stated:

> "As evidencing the need for the continuing and pervasive surveillance of Bond and Share which the Act provides, the participants opposing Bond and Share's application [for exemption] have pointed to the history of improprieties practiced by Bond and Share on its subsidiaries, including United, and to conflicts of interest which might arise if Bond and Share were to hold United. * * * These potentialities of conflict and abuse of the power to control . . . make it necessary in the public interest and the interest of investors that the desired exemption be denied."

And in *Standard Oil Company*, 10 S. E. C. 1122, 1129 (1940), we also observed:

> "In the present situation, our record discloses that there have been intrasystem transactions, including intercompany advances and servicing arrangements, which are of the type which was recognized by Congress as the subject of potential abuse and which were, therefore, made the subject of our scrutiny. While we wish to draw no conclusion as to the existence of actual abuses with respect to such transactions within applicant's system, it is necessary and appropriate for us to retain jurisdiction over applicant and its subsidiaries in order to scrutinize such transactions and prevent the possibility of abuses contrary to the public interest. * * *"

Cities points out that exemptions have been granted where there was a public minority interest in the applicant system. However, the question whether the presence of a minority interest involves a detriment which the statute seeks to prevent must, of course, be resolved on the facts in

each case. In this case if there is such a detriment it would flow from the existence of the minority interest in the context of the intrasystem transactions and affiliations. With respect to the cases cited by Cities, it may be noted that in certain of them the minority interest did not exist, as it does here, in a registered holding company to which Section 11(b)(2) proceedings had been directed.[20] In another case, while there was a minority interest in a registered subholding company, we were satisfied that elimination of the minority interest was not required where, among other things, the intrasystem transactions, which consisted exclusively of a servicing arrangement, were to be performed at cost.[21] In another case there was no indication of any intrasystem transactions.[22] Finally, in two other cases it appears that the public minority interest was small and was viewed as de minimis requiring no action.[23]

As had been noted, Fuel Oil is intimately tied to the Cities system by a multiplicity of affiliations and intrasystem transactions. Operationwise Fuel Oil has been assimilated into, and for all practical purposes is a part of the Cities oil and gas system, supplying its available crude oil to a Cities refinery for processing, acquiring its marketing requirements from that refinery, and then distributing these products in stations carrying the Cities emblem. The participants who contend that these relationships and trans-

[20] *Standard Oil Company*, 14 S. E. C. 342 (1943); *Eastern Gas and Fuel Associates*, 30 S. E. C. 834 (1950). In the context of a system which meets the conditions for exemption under Section 3(a) of the Act we have not invoked the "unless and except" clause to reach all parts of the system but have generally confined remedial action under Section 11(b)(2) to the holding company.

[21] *Electric Bond and Share Company*, Holding Company Act Release No. 11675 (January 27, 1953).

[22] *Arkansas Light and Gas Company*, Holding Company Act Release No. 12748 (December 17, 1954).

[23] *International Utilities Corporation*, 21 S. E. C. 283 (1945); *Texas Utilities Company*, 31 S. E. C. 367 (1950).

actions create a situation requiring remedial action with respect to the minority interest rely primarily on the circumstances surrounding the termination of Fuel Oil's refining operations at Bossier City and Fuel Oil's arrangement with Cities Refining to which we now turn.

V. Bossier City Refinery and Arrangement Between Fuel Oil and Cities Refining.

As noted above, for some years prior to 1945, Fuel Oil (through Arkco) owned and operated a refinery at Bossier City, Louisiana. By 1938 that refinery was becoming obsolete, and it appeared that a substantial investment would be required to modernize it. In 1940 or 1941 active consideration was given to the refinery problem, at which time the Benedum representatives on Fuel Oil's board of directors opposed the investment of the needed additional funds for modernizing of the refinery, principally on account of the rapidity of refinery obsolescence. Studies of the problem continued, and in 1944, the company's engineers, on the basis of operations for 1943 and the first four months of 1944, recommended the continuation of operations. The following year Lummus Company, independent refinery design engineers, was employed to prepare a report on the methods and cost of modernizing the refinery. After an exhaustive study, in August 1945 Lummus submitted for consideration 38 different plans for the complete or partial modernization of the refinery, and later that month, at the request of the management, it submitted a supplemental study, containing six additional plans. Apparently Lummus made no study to determine the advisability from Fuel Oil's viewpoint of modernizing the plant as against shutting it down.

On September 20, 1945, Fuel Oil's board of directors voted to shut down the Bossier City refinery and to exe-

cute a contract ("Refinery Contract") with Cities Refining under which the latter would supply from its Lake Charles Refinery Fuel Oil's refined products requirements.[24] The Refinery Contract was entered into the same day and was signed on behalf of Fuel Oil by its vice-president, and on behalf of Cities Refining by its president, who was then president and a director of Fuel Oil and a director and chief engineer of Cities. Operations at the Bossier City refinery were substantially discontinued in October, 1945 and completely shut down the following month.

The Lake Charles refinery, which was completed in 1943, was designed originally to run at capacity of 70,000 bbls. a day for the production of wartime products, particularly aviation gasoline, and at a capacity of 100,000 bbls. a day for the production of peacetime products. On August 1, 1945, about seven weeks before the decision to shut down the Bossier City refinery, the Government had cancelled its aviation gasoline contract with Cities Refining calling for approximately 25,000 bbls. a day. The cancellation made necessary a complete rearrangement in the method of processing at the Lake Charles refinery to provide for the production of civilian-type petroleum products. Following the cancellation, Cities Refining found it necessary to apply, on November 28, 1945, to the Reconstruction Finance Corporation, from which it had borrowed some $55,000,000 to help finance construction of the Lake Charles refinery, for suspension of monthly payments under the loan agreement, and a suspension was obtained for six months beginning December 1, 1945.

The objecting Fuel Oil stockholders contend that the decision to shut down the Bossier City refinery was made in the interests of the Cities system and compelled by its

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[24]Supplements to the 1945 contract, embodied in letters dated December 18, 1947, and July 27, 1948, place the contract on a month-to-month basis.

needs. They argue that the refinery was abandoned in order to meet the needs of Cities Refining for crude oil, which was then in short supply, by supplying it with crude oil of Fuel Oil that had theretofore been processed in Bossier City and to meet Cities Refining's needs for a market for its then excess refining capacity by having Fuel Oil purchase its marketing needs from the Lake Charles Refinery. Cities, on the other hand, contends that in entering into the Refinery Contract Cities Refining bailed Fuel Oil out of problems it faced, as a result of the sudden end of the war, in connection with having available a marketable product, which could only be obtained from the Bossier City refinery if it were modernized. In our opinion the decision to shut down that refinery was motivated at least in part by the desire of Cities Refining to obtain a replacement for the then recently cancelled government contract, and it appears clear that the Cities management recognized at the time that it had to consider the effect of the shut-down upon the interests of Fuel Oil's public stockholders. As will be more fully pointed out below, the Refinery Contract provided for price adjustments which were based on hypothetical continued operations of the Bossier City plant and were intended to preserve the economic status which Fuel Oil might reasonably be expected to achieve had it in 1945 modernized that refinery. This provision was obviously considered necessary to protect the public minority stockholders.

As noted above, Fuel Oil sells the major portion of its crude oil, both produced and purchased, to Cities Refining, and Fuel Oil and its subsidiary, Orange State, purchase the finished petroleum products which they market through their retail gasoline distribution stations largely from Cities Refining. The prices paid to Cities Refining for refined petroleum products are basically the lows of the Gulf Coast competitive prices ("posted prices"), less (1) in the case of gasolines, certain discounts determined on the basis of

day by day dealings and negotiations on specific products, including discounts on special accounts, and (2) in the case of all refined light oil products, excluding aviation gasoline, a discount of 5½% on the amount by which purchases of individual refined products in any calendar year exceed those made in 1953. Prices for aviation gasoline are determined separately from time to time.

In addition, the Refinery Contract provides for certain adjustments, which as noted above are based on assumed continued operations of a modernized refinery at Bossier City, in the prices paid by Fuel Oil to Cities Refining for refined products. Thus, the contract provides that payments should be subject to monthly credits to reflect Fuel Oil's cost of such products based upon an assumption of a capital investment sufficient to modernize the Bossier City refinery so as to produce the refined products supplied to it by Cities Refining and giving consideration to the earnings of Fuel Oil from other facilities related to its refinery operations and to proper allocations to such operations of general overhead costs.

As a basis for determining the price adjustments, an assumed cost of the refinery of $7,416,000 issued, with approximately $2,000,000 representing undepreciated balance of the refinery that existed in 1945 and $5,400,000 representing cost of modernization based on one proposal in the supplemental report of Lummus Company involving a 20,000-bbl. per day throughout capacity. By means of very detailed monthly calculations of the value of the hypothetical refined products and costs of operation of the refinery, a "refinery margin", which may indicate a profit or a loss, is determined. To such refinery margin certain credit adjustments are made in favor of Fuel Oil for (1) the profit Arkla, Fuel Oil's former subsidiary, would have made on sales to the Bossier City refinery of gas to be used as fuel; (2) the added transportation cost to Fuel Oil

reflecting the fact that the Lake Charles plant is approximately 200 miles south of Bossier City, and (3) the estimated loss of earnings of Fuel Oil's pipe line subsidiary in those months when its actual earnings are less than the computed earnings it would have realized had it continued to transport crude oil to the Bossier City refinery as it did before the shutdown of that refinery.[25] If the resulting balance indicates a profit, Fuel Oil is given credit therefor against the purchase prices it pays to Cities Refining; if, however, the resultant balance shows a loss it is added to Fuel Oil's cost of purchases from Cities Refining. From October or November 1945 to December 31, 1954, the credits to Fuel Oil have aggregated $16,604,170 although in some months the refinery margin has been a red figure.[26]

Fuel Oil renders to Cities Refining monthly reports with respect to the hypothetical refinery which are based on an assumed daily delivery of an average of 20,000 bbls. of crude oil of five types, generally in the relative amounts employed by the actual refinery prior to its abandonment. A value for refined products is arrived at by applying certain percentages of yield set out in the Lummus report for various products and then multiplying the assumed production by average market prices for each type of product. The cost of the refinery input which is assumed to be obtained in the Bossier City area to the extent available at favorable transportation costs is computed at the cost of the crude oil in the field plus transportation. The cost of operating labor is assumed to be the actual wages paid for various work in 1945 adjusted for subsequent wage

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[25]Adjustments credited to Fuel Oil in respect to deficient earnings of its pipe line subsidiary were necessary only during 1946, 1947, and 1952.

[26]In 1954, the refinery margin showed a loss of $657,717; however, Fuel Oil received credits aggregating $421,125 representing lost profits on natural gas sales and added transportation costs resulting in a net loss to Fuel Oil for the year of $236,592.

increases in the area and an increased number of employees resulting from reduced working hours, and is based on a 24-hour three-shift day without shutdowns or overtime.

The complexity of the hypothetical refining arrangement admittedly results in errors in the monthly statements. These errors as well as other alleged errors and improprieties in management form the basis for various claims which the objecting stockholders have asserted against Cities Refining, and to which Cities has raised defenses. However, in our view, it is not appropriate for us to undertake to examine or adjudicate any possible inter-company claims at this stage of the proceedings. Our jurisdiction under the Act to consider claims of this type arises in connection with our passing on the fairness of a plan filed under Section 11(d) or 11(e) of the Act, and we would reach such consideration only in the event there is hereafter presented to us a form of compliance with Section 11(b)(2) which makes such consideration relevant to a determination of its fairness. The errors in computation merely demonstrate one of the consequences of an intercompany arrangement of the character here involved.

The inadequacy of the arrangement as a method of reconciling the conflict of interest between Fuel Oil and Cities is further emphasized by the fact that the hypothetical refinery is not geared to meet either in quality or quantity the refined products requirements of Fuel Oil. A. P. Frame, whose positions in the Cities system include that of a director and vice president of Cities Refining and a director of Fuel Oil, testified that time was making the arrangement more complicated and that the relationships under it will have to be simplified. Frame explained that the issue of discounts has been coming up with greater frequency and questions are presented as to the ability of the hypothetical refinery to produce the quality of refined products that will be required by Fuel Oil in the future.

In addition, it may be noted that beginning with 1947 Fuel Oil's purchases have exceeded the production of the hypothetical refinery and, with the exception of 1949, the excess has increased annually. In 1954 such excess reached 6,371,920 barrels or almost as much as the annual production of the hypothetical refinery, which averaged approximately 6,880,000 barrels throughout the period.

The hypothetical refinery for all intents and purposes is static and not dynamic as would be the case if there were actual operations which were constantly scrutinized and adjusted so as to produce the maximum economic benefit to Fuel Oil. The nature of the attention paid to the arrangement is indicated by the fact that Fuel Oil's chief engineer stated that the engineering department has nothing to do with the hypothetical refinery statements and that they are prepared by the accounting department, while Fuel Oil's chief accounting officer stated that the work done by the accounting department was mechanical and that all basic determinations and changes are made by the engineering department. In this connection it may also be noted that while five so-called public stockholder directors support Fuel Oil's position that no action is required with respect to the public minority interest, four of them who testified in these proceedings indicated general unfamiliarity with the Refinery Contract and with the hypothetical refinery.[27]

An engineer consultant with experience in refinery design, operations and construction, called as an expert witness by Pennroad Corporation, testified that in his opinion the arrangement between Fuel Oil and Cities Refining had not secured for Fuel Oil all the advantages

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[27]Since the election of the new directors in April 1953 none of the contracts between Fuel Oil and the wholly-owned subsidiaries of Cities or modifications of such contracts effected after that date have been presented to the board of directors or authorized or approved by it.

of operating the Bossier City refinery. He based this opinion on the view that the procedures used in the monthly accounting between the companies, in which every effort has been made to trend operating expenses to correspond with current costs, have not been consistent and have generally been to the disadvantage of Fuel Oil, and that in a realistic operation steps would have been taken to reduce expenses and various plant and processing improvements would have been made to increase profits.

The problem of conflicts of interest is also illustrated by various negotiations between Fuel Oil and Cities Refining. As previously pointed out, Fuel Oil's purchases have exceeded the production of the hypothetical refinery for many years, and it was this situation which induced Fuel Oil to initiate negotiations with Cities Refining that culminated in the 5½% discount it has been receiving since January 1, 1954. These negotiations were conducted on behalf of Fuel Oil by John A. Welch, its vice president and general manager, and on behalf of Cities Refining by its president, with Frame, who as already noted was a director and vice president of Cities Refining as well as a director of Fuel Oil, acting as he characterized it "in his usual position as mediator." Welch testified that he asked for at least a 6% discount but Cities Refining refused, and when asked why he yielded and accepted the 5½% discount, he testified that this was the best deal he could make. Without in any way passing judgment on whether the discount was high enough, the conflict of interests inherent in the situation is evident.

Of similar significance were the circumstances relating to the fixing of the cost of the hypothetical refinery. As pointed out above, it was assumed that the cost of modernizing the Bossier City refinery would be $5,400,000. This was based on one proposal in the supplemental report of Lummus Company involving a base modernization cost of

$4,900,000, with $500,000 added as the estimated cost for requisite off-site facilities. The latter item was the subject of a conference between Fuel Oil and Cities Refining in January 1946 attended by Frame. The record indicates that although the representatives of Cities Refining at that conference understood that the amount was agreed upon, the representatives of Fuel Oil understood only that there was tentative agreement and that the matter was to be given further study. Subsequently, Fuel Oil's engineers, after consultation with Lummus Company, concluded that the proper cost of such facilities should be $175,000. In March 1946, this figure was submitted to Frame who referred the matter for study to the chief engineer of the Cities system service company, and in April 1946, the latter concluded that the proper amount should be $902,300. Although there is no indication that this dispute has ever been settled, calculations have been continued on the basis of $500,000.

Cities' position with respect to the Refinery Contract is, in essence, that the contract is fair and has been advantageous to Fuel Oil, and has contributed to the success that Fuel Oil has enjoyed. However, even assuming that such is the case, the need for taking action with respect to the public minority interest is not contingent upon a finding of spoliation or abuse. The inherent conflict of interests which pervades all aspects of dealings between the Fuel Oil system and the Cities system is such that it constitutes a detriment to the interests of the minority stockholders, who are thereby deprived a management conducting Fuel Oil's affairs with an eye single to its own advantage.

VI. Conclusion and Required Action.

As we have already stated, there is a multiplicity of relationships and transactions between Fuel Oil and other segments of the Cities system, and as a practical matter

Fuel Oil is part of the integrated operations of the Cities system. As we have seen, a conflict of interest manifests itself continuously between the Cities system on the one hand and Fuel Oil on the other, at least insofar as its impact on the minority stockholders of Fuel Oil is concerned. Cities itself recognized this problem, and the complex hypothetical refinery arrangement was devised as a partial solution. However, it merely aggravates the situation, and demonstrates the futility of trying to solve the conflict of interest problem in circumstances such as those presented by compromise techniques which seek to impose safeguards but do not directly attack the underlying condition that creates the problem. In *Sioux City Gas and Electric Company, et al.*,[28] we noted the problems involved in attempts to prevent abuses from conflicts of interests short of eliminating the minority interest:

> "The management of . . . [the parent] has heretofore attempted to straddle the dilemma posed by the conflict between the existence of a substantial public stockholder interest in . . . [the subsidiary] and the necessity for integrated operation by superimposing upon such operation the check of independent experts or advisers to review the terms of all important intercompany contracts. But it is recognized that such a device cannot obviate the potential conflicts of interest which arise on a day to day basis and that an attempt to extend it so as to ensure that both companies deal with each other as independent entities would necessarily tend to eliminate the benefits of fully integrated operation. Under such circumstances the continued existence of the minority interest . . ., where the properties are to be operated as an integrated system, constitutes an undue and unnecessary corporate complexity . . . This complexity in turn gives rise to an inequitable distribution of voting power, since the widely

[28]30 S. E. C. 5, 14 (1949).

> scattered minority stockholders of . . . [the subsidiary] are unable effectively to exercise their voting power and are, as a practical matter, disfranchised. The only type of action which would effectively meet both of these problems is action such as that contemplated by the plan of converting the respective interests of the security holders into interests in the entire system rather than differing interests in the different segments of the system."

We are of the view that the "existence of the public minority interest in Fuel Oil constitutes a complexity and results in an inequitable distribution of voting power within the meaning of Section 11(b)(2)" of the Act with precludes the grant of an exemption under the "unless and except" clause of Section 3(a). We are of the further view that this condition can be satisfactorily rectified only by eliminating the public minority interest in Fuel Oil or by Cities disposing of its interest in Fuel Oil. Since Fuel Oil's compliance with Section 11(b)(2) has thus far been effected without the need for our entering any order under the Section, we shall not enter such an order at this time and shall afford Cities and Fuel Oil a reasonable opportunity to submit an appropriate program of compliance to effect either the elimination of the minority interest or the disposition of Cities' interest in Fuel Oil.

In view of our conclusions with respect to the public minority interest, we find that it would be detrimental to the interest of investors to grant the exemption under Section 3(a)(5), and we shall so order.

By the Commission (Chairman Armstrong and Commissioners Orrick, Patterson, Hastings, and Sargent).

ORVAL L. DUBOIS
Secretary

Order Denying Exemption Pursuant to Section 3(a)(5) of the Act

UNITED STATES OF AMERICA

BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

August 31, 1956

IN THE MATTER

of

CITIES SERVICE COMPANY
ARKANSAS FUEL CORPORATION

Files Nos. 31-622; 54-186; 59-93; and 70-1804

(Public Utility Holding Company Act of 1935)

Cities Service Company, a registered holding company, having filed an application for an order exempting it and each of its subsidiaries from the provisions of the Public Utility Holding Company Act of 1935, pursuant to Section 3(a)(5) thereof; and

Public hearings having been held on said application after appropriate notice, briefs having been filed, and the Commission having heard oral argument; and

The Commission having this day entered its Findings and Opinion herein; on the basis of such Findings and Opinion

IT IS ORDERED that the aforesaid application of Cities Service Company be, and it hereby is, denied.

By the Commission.

ORVAL L. DUBOIS,
Secretary.

[Not Complete Text—Deletions Indicated]

(Holding Company Act Release No. 11511)

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C.

October 1, 1952

Findings and Opinion of the Commission

IN THE MATTER

of

ARKANSAS NATURAL GAS CORPORATION
CITIES SERVICE COMPANY

File No. 54-186

ARKANSAS NATURAL GAS CORPORATION AND ITS SUBSIDIARIES

AND

CITIES SERVICE COMPANY

Respondents

File Nos. 59-93 and 70-1804
(Public Utility Holding Company Act of 1935)

SIMPLIFICATION AND INTEGRATION OF HOLDING COMPANY SYSTEM

Plan under Section 11(e)—Necessity

Plan filed by parent and its subsidiary, both registered holding companies, pursuant to Section 11(e)

of the Act, providing for separation of subsidiary's utility and non-utility interests, its elimination as a holding company, and the change of its capital structure, consisting of preferred, common and non-voting Class A common stocks, to debentures and a single class of voting common stock, *held* necessary to effectuate provisions of Sections 11(b)(1) and 11(b)(2) of the Act.

Plan under Section 11(e)—Fairness—Claims against Parent

Plan filed by parent and its subsidiary, both registered holding companies, pursuant to Section 11(e) of the Act, providing for retirement of subsidiary's preferred stock by payment of redemption price, for the retirement, through an exchange of securities, of the subsidiary's common and Class A common stocks, and for cash payments by parent to the public holders of such securities in amounts reflecting a compromise of corporate and class claims asserted against it, *held*, fair.

Appearances:

H. C. WALKER, JR., of Blanchard, Goldstein, Walker & O'Quin, and ROBERT ROBERTS, JR., for Arkansas Natural Gas Corporation.

CLINTON J. RUCH, EUGENE R. SULLIVAN and EVERETT W. YOUNG of Frueauff, Burns, Ruch & Farrell and JOSEPH L. WEINER, for Cities Service Company.

PERCIVAL E. JACKSON, BERNARD S. KANTON, and THEODORE N. TARLAU, for Arkansas Natural Gas Corporation Class A Common Stockholders Committee.

F. S. WOOD, JOHN F. B. MITCHELLS, JR., CLARENCE FRIED, and ELLIOT A. WYSOR, of Hawkins, Delafield & Wood, and BERNARD D. CAHN, for Arkansas Natural Gas Corporation Common Stockholders Committee.

C. L. WALLACE, of Weller, Wicks and Wallace and SMITH W. BROOKHART and BENJAMIN H. DORSEY, for M. L. Benedum and Sarah N. Benedum.

JACOB GOLDBERG, for Federal Power Commission.

M. MORTON WEINSTEIN, for the Division of Public Utilities of the Commission.

These proceedings involve an amended plan filed pursuant to Section 11(e) of the Public Utility Holding Company Act of 1935 ("the Act") by Arkansas Natural Gas Corporation ("Arknat") and its parent, Cities Service Company ("Cities"), both registered holding companies. The plan, which is proposed as a means of complying with Sections 11(b)(1) and 11(b)(2) of the Act and our orders under the former section, provides in general for the simplification of Arknat's corporate structure, the separation of its utility and non-utility interests, its merger with one of its subsidiaries, and the settlement of certain claims asserted against Cities.

After appropriate notice, public hearings were held at which representatives of various stockholder groups, and other interested parties appeared. Briefs were filed, and we heard oral argument.

On the basis of an independent consideration of the record, we make the following findings.

I. Description of the Arknat System.

Arknat, a Delaware corporation, resulted from a merger in 1928 of two subsidiaries of Cities and a third unaffiliated company. Arknat's business is almost exclusively that of a holding company, its major assets consisting of all the outstanding stocks of its principal operating subsidiaries, Arkansas Louisiana Gas Company ("Arkla") and Arkansas Fuel Oil Company ("Arkfuel").[1] Arkla, which is more fully described below, is a gas utility company engaged in the purchase, production, transmission, distribution and sale of natural gas in Louisiana, Texas, and Arkansas. Arkfuel, a non-utility company, operates chiefly in the South and Southwest and is engaged in the production and transportation of crude oil, the processing of natural gas, and the marketing of petroleum products.

* * *

II. Prior Proceedings.

On May 5, 1944, pursuant to Section 11(b)(1) of the Act, we ordered Cities to limit its operations to those of a single integrated gas utility system, but, in recognition of the extensive non-utility character of Cities' operations, we did not foreclose its retaining those operations and complying with Section 11(b)(1) by disposing of its utility holdings. In addition, we required Arknat to dispose of its interests in all of its subsidiaries except Arkla.[2] On October 12, 1944, at Cities' request, we issued a supplemental order which provided that Cities might retain its non-utility interests and dispose of its utility holdings, including its interest in Arkla.[3] To effect partial compli-

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[1] [Footnote omitted.]

[2] *Cities Service Company*, 15 S. E. C. 962.

[3] *Cities Service Company*, 17 S. E. C. 5.

ance with these orders, Arknat and Arkla filed joint applications and declarations on March 31, 1948, proposing the disposition by Arknat of its interest in the gas utility assets of Arkla. At hearings thereon questions were raised as to Arknat's compliance with the requirements of Section 11(b)(2), and subsequently, on February 9, 1949, we instituted Section 11(b)(2) proceedings directed to Arknat and its subsidiaries and to Cities,[4] which were consolidated with the proceedings on the joint applications-declarations.

In January 1950 Arknat filed a Section 11(e) plan ("1950 plan"), and we consolidated the proceedings on this plan with the prior proceedings. The notice and order for hearing raised as an issue whether, because of certain claims asserted against Cities and its subsidiaries, the interests of Cities or of any other Arknat stockholders should be subordinated to the interests of other security holders.[5] After hearings were held on this plan, Arknat and Cities filed the amended plan on December 3, 1951, and hearings were reconvened. The amended plan differs from the 1950 plan essentially in that it provides for a settlement of the claims against Cities and the redemption of Arknat's preferred stock with proceeds derived from the issuance and sale of debentures instead of new preferred stock as provided in the 1950 plan.

III. The Plan.

The principal provisions of the amended plan ("the plan") are in substance as follows:

* * *

6. Arkla's presently outstanding no par value common stock will be reclassified into 3,801,609 common shares having a par value of $5 per share.

[4] Holding Company Act Release No. 8842.
[5] Holding Company Act Release No. 10372 (January 31, 1951).

7. Arkfuel and Arknat will merge, and the surviving corporation, under the name of Arkansas Fuel Oil Corporation ("Fuel Oil"), will issue 3,801,609 shares of $5 par value common stock.

8. The new common stocks of Arkla and Fuel Oil will be distributed to the holders of the common and Class A stocks of Arknat on the basis of one-half share of each of the new stocks for each share of Arknat common and Class A stock.

9. In full settlement of all claims that have been or may be asserted against Cities and its subsidiaries in these proceedings, Cities will make cash payments aggregating $4,069,268.75 to the public holders of Arknat's common and Class A stocks, on the basis of $1.50 per share of Class A stock and 25¢ per share of common stock.[6]

IV. Position of the Participants.

* * *

The Division of Public Utilities ("the Division") is of the view that the plan is necessary and fair and equitable and that the related transactions are in conformity with the other applicable provisions of the Act, except as to those transactions the complete details of which have not yet been supplied for the record. Accordingly, it recommends approval of the plan with reservation of jurisdiction over the matters which are still incomplete.

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[6]No payment will be made to present or former officers or directors of Arknat, its subsidiaries, or Cities, or to any person who, on the organization of Arknat, was entitled to receive 1% or more of Arknat common stock in exchange for stock of the unaffiliated company which merged with the two Cities subsidiaries, or to successors in interest (other than by purchase) of any such officer, director or person.

V. Applicable Statutory Standards.

In order to approve a plan filed pursuant to Section 11(e) of the Act, we must find that it is necessary to effectuate the provisions of Section 11(b) of the Act, is fair and equitable to the persons affected, and meets the other applicable standards of the Act.

A. *Necessity*

We have consistently held that a plan is necessary under Section 11(e) if it provides an appropriate means for achieving the results required by Section 11(b), although it might not be the only plan capable of effectuating the provisions of the statute.[7]

The proposed divestment by Arknat of its interest in Arkla will result in the separation of the utility and non-utility interests of Arknat in accordance with the standards of Section 11(b)(1) and consistent with our orders thereunder. In addition, the plan will facilitate Cities' disposition of its interest in the utility properties owned and operated by Arkla. Although the plan does not provide for such disposition by Cities, it is established that a plan need not effectuate complete compliance with the Act to be necessary within the meaning of Section 11(e).[8] In this connection it should be noted that Cities has stated that it will expeditiously dispose of its Arkla holdings after consummation of the plan.

Arknat's Class A stock represents approximately 46% of the combined common and Class A equity of the company, and the public holdings of Class A stock alone amount

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[7] *Electric Power & Light Corporation*, Holding Company Act Release No. 8889, note 8 (March 2, 1949) and cases there cited.

[8] *Lahti* v. *New England Power Association*, 160 F. 2d 845 (C. A. 1, 1947); *Philadelphia Company*, Holding Company Act Release No. 11155 (April 7, 1952); *The United Corporation*, Holding Company Act Release No. 8396 (August 5, 1948).

to 35% of the combined equity, but, as previously noted, the Class A stock has no voting power. This situation constitutes an unfair and inequitable distribution of voting power in direct conflict with the standards of Section 11(b)(2) of the Act. The plan will remedy this condition because it proposes to eliminate the common and Class A stocks by exchanging them for common stocks of Fuel Oil and Arkla with full voting privileges.

In addition, the plan will simplify the corporate structure of the system. The capitalization of each of the corporations to emerge from the reorganization will consist of debt and only one class of stock; Arknat, through merger with its operating oil subsidiary, will be eliminated as a holding company; and Arkla will sell its holdings in its only subsidiary.

The new common stocks of both Fuel Oil and Arkla will under their respective charters be entitled, among other things, to cumulative voting privileges in the election of directors and to conditional pre-emptive rights. However, Arkla's charter does not require an affirmative vote of two-thirds of the stock to amend such provisions of the charter. In our opinion, the protection of investors requires that the charter should be amended to make such provision. In addition it appears that Arkla's charter needs revision in other respects, principally as to the extent of the powers of the board of directors, to adapt it to modern standards for a company with a large number of public stockholders. Our order to be issued herein will reserve jurisdiction with respect to such revision of Arkla's charter, including the requirement of a two-thirds vote above referred to, as may be appropriate for the protection of investors.

The Class A and Common Committees have objected, among other things, to (1) the proposed capital structures of Arkla and Fuel Oil, (2) the proposed intercompany property transfers, (3) the proposed distribution of one-half

share of the stocks of Arkla and Fuel Oil, and (4) the minority interest that will remain in Fuel Oil after consummation of the plan.

(1) *Pro Forma Capitalizations*

The Class A Committee contends that the plan would create in place of Arknat two financially weaker companies with excessive debt which would seriously hamper their future financing. At the outset it should be noted that the continuation of Arkla and Arkfuel as co-subsidiaries of Arknat has been foreclosed by our orders under Section 11(b)(1). We accordingly confine our discussion of this contention to the financial structures of the two companies which will emerge from the reorganization.

Appendix B hereto is a consolidated balance sheet as of December 31, 1951, of Arknat and Arkfuel and its subsidiaries, the constituents of Fuel Oil, actual and pro forma giving effect to the provisions of the plan. As shown therein, on a pro forma basis Fuel Oil's capital structure consists of debentures in the principal amount of $23,000,000 and common stock. The debentures, together with lease purchase obligations of $2,094,337, represent 40.6% of total capitalization and surplus, and the common stock equity is 59.4% thereof.

* * *

Under the circumstances, we do not consider there is any basis for any adverse findings with respect to the proposed capital structure of Fuel Oil.[10]

(2) *Intercompany Property Transfers*

* * *

Under all the circumstances, we are of the opinion that the proposed transfers of the Carthage Acreage and gaso-

[10] [Footnote omitted.]

line plants may be approved as necessary within the meaning of the Act.

(3) *Half-Share Distribution of New Stocks*

The Common Committee objects to the provision in the plan whereby the holders of Arknat's common and Class A stocks will receive, for each share held, one-half share of each of the new common stocks of Arkla and Fuel Oil, instead of one full share in each of those companies as proposed in the 1950 plan. The Committee contends that the aggregate market value of the shares proposed to be issued under the plan would tend to be less than the aggregate market value of the greater number of shares which would be issued on a share for share basis, and that the reduction in the number of shares issued will make it easier for Cities to acquire the portion outstanding in the hands of the public. The Committee also asserts that present holders of odd numbers of Arknat Class A or common shares would have to buy or sell a half share of the new Fuel Oil and Arkla common stocks to round out his holdings, and that to the extent that more "odd lots" result, holders would be subjected to additional expense when disposing of such lots.

The above contentions, in so far as they have any bearing on the necessity of the plan, are either without substance, or outweighed by other factors. It is not likely that Cities will acquire additional Arkla stock, for it is to dispose of its holdings therein after consummation of the plan, and we find no basis for concern in the possibility that Cities' purchases of Fuel Oil stock may be facilitated by the proposed half-share distribution. Further, were the new shares to be distributed on a share for share basis, Arkla and Fuel Oil would each have outstanding about 7,600,000 shares, with relatively low market prices. We

think that, in the absence of any compelling necessity for the issuance of such large numbers of low-priced shares, the interests of Arkla and its stockholders would be better served by the issuance of half the number of shares. With fewer but higher priced shares outstanding, future equity financing would be facilitated and more economical, and stock transfer taxes would in all likelihood be less. Even if the new shares to be issued under the plan would have a lower market value than would a double number issued on a share for share basis, the difference should be slight. The present holder of an odd number of shares would not be penalized, for the plan makes provision for stockholders who receive scrip certificates for fractional interests to sell or purchase half shares without the payment of commissions or any other incidental expenses. And to the extent that any increase in the number of odd lots for trading purposes would result, we do not think this is a factor of sufficient significance to require a modification of the plan.

(4) *Minority Interests*

After consummation of the plan Cities, as owner of 51.5% of the combined common and Class A stocks, will emerge with a similar percentage of the new common stocks of Fuel Oil and Arkla. Cities will thereafter dispose of its holdings in Arkla, but will retain its holdings in Fuel Oil. The Class A Committee objects to the failure of the plan to make provision for eliminating the minority public interest which will remain in Fuel Oil after consummation of the plan.

We recognize that the continued existence of a minority interest in Fuel Oil presents a problem which may require corrective action. However, in view of the fact that Fuel Oil will remain under our jurisdiction as long as Cities is a registered holding company (a status which will continue

until terminated by us), we believe that consideration of this problem may be deferred until a later date.

In the interim, provision should be made to give the public minority stockholders adequate representation on the initial board of directors of Fuel Oil, and accordingly prior to consummation of the plan Arknat should submit to us the names of the proposed directors for such action as we may deem proper.[20]

In view of the foregoing, we find that, subject to the reservations noted, the plan provides an appropriate means for achieving the results required by Section 11(b).[21]

B. *Fairness of the Plan*

The fair and equitable standard to be applied in Section 11(e) reorganizations requires that each security holder, in the order of his priority, receive from that which is available for the satisfaction of his claim, the equitable equivalent of the rights surrendered.[22]

As previously stated, the plan provides for redemption of Arknat's preferred stock, either in cash or in debentures, at the call price of $10.60 per share, plus unpaid dividends. No one has contended that the preferred stock is not worth its call price, and the record indicates that such value is present. The only problem with respect to the redemption of the preferred stock relates to certain shares acquired by Cities at less than their par value, which we discuss below.

The plan also provides for *pari-passu* distribution of the new common stocks of Arkla and Fuel Oil among the holders of Arknat's common and Class A stocks, as well as cash payments by Cities to the public holders of the common and

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[20] A similar submission should be made with respect to Arkla's initial board of directors.

[21] [Footnote omitted.]

[22] *Otis & Company* v. *Securities and Exchange Commission*, 323 U. S. 624, 639-40 (1945); *S. E. C.* v. *Central-Illinois Securities Corporation*, 338 U. S. 96 (1949).

Class A stocks in settlement of any claims asserted against it. This presents no problem of allocation of securities as between senior and junior security holders since the common and Class A stockholders have equal rights as to assets and earnings. The sole problem of fairness presented relates to a determination of whether the proposed settlement gives proper recognition to the special equities affecting the various groups of stockholders.

There are two major categories of claims assertedly giving rise to special equities: those based upon Cities' alleged mismanagement of Arknat apart from the marketing of the Class A stock, and those arising from such marketing operation. The latter category consists of claims asserted in behalf of Arknat ("corporate claims") and of a class claim asserted in behalf of the publicly held Class A stock. We now turn to a consideration of these claims and the defenses raised thereto.

1. *The Claims and Defenses*

The Class A Committee contends that infirmities founded upon the equitable principles applied in *Taylor* v. *Standard Gas & Electric Co.* (the "Deep Rock" case)[23] exist with respect to the securities holdings of Cities which require that such holdings should not be given full recognition in the distribution of securities under the plan.

* * * *

The Class A Committee asserts that the corporate claims involve damage caused Arknat by Cities in the aggregate amount of over $31,000,000, plus interest,[24] and that the proposed settlement of such claims by the payment of 25¢ per share to the public holders of the equity securi-

[23] 306 U. S. 307 (1939).

[24] This figure does not include the corporate claim, noted above, that the common stock of Arknat received by Cities in the merger was bonus stock and should be cancelled.

ties, which is equal in effect to a payment to Arknat of $1,900,804, and the proposed settlement of the class claims by the payment of $1.25 per share to the holders of Class A stock, are inadequate. The Committee also objects to the form of the proposed settlement, urging that Arknat should be compensated directly for the wrongs done to it, and that a settlement of the wrong to the Class A stockholders as a class should take the form of a reallocation of securities.

The Common Committee, like the Class A Committee, complains that the proposed cash payment to the equity security holders is inadequate as a settlement of Arknat's claims, which are asserted to total from about $48,000,000 to $55,000,000, exclusive of interest.

* * *

Cities takes issue with all of these contentions. It argues that there is no basis for invoking *Deep Rock* principles since there is no history of spoliation and Arknat is solvent and the public holders will receive participation regardless of any subordination of Cities' holdings.

* * *

The Division has expressed the view that the settlement is adequate and appropriate.

* * *

2. Conclusions as to Fairness of Proposed Settlement.

Cities states that it proposed the settlement of the claims asserted against it not because it believed they have any merit, but in order to avoid protracted litigation with the resulting delay in approval and consummation of the plan. In our opinion, however, there are elements of these claims which have sufficient merit to require recognition and which render this an appropriate situation for compromise.

* * *

In weighing the adequacy of the proposed settlement, Cities' general defenses, as well as its specific defenses in respect of both the corporate and class claims, must be taken into account. Such general defenses include pleas of laches and the statute of limitations. While such defenses do not bar our examination of the claims, we have given consideration to the facts on which those defenses have been based in determining what fairness and equity demand in the way of the extent of recognition of such claims. We turn now to an examination of the fairness of the settlement before us.[56]

* * *

As previously noted, in determining whether the proposed settlement is fair, we are not required to fix precise dollar valuations for any particular claim. Our obligation is satisfied when we determine whether, considering all the circumstances in the case, the proposed settlement accords sufficient weight to the equities of the interests affected that it may be said to fall within the range of fair treatment of such interests.[66]

In reaching our conclusion that the offer of settlement produces a fair and reasonable over-all result under the circumstances of this case we have carefully weighed the merits of the various claims together with the claims for interest on such claims, the defenses thereto, and the numer-

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[56]The Class A Committee has urged that redress for the corporate injuries should be made to Arknat rather than paid directly to the public equity security holders and that redress for injury to the public Class A stockholders should take the form of a security allocation rather than a cash payment. However, the form of a proposed claim settlement is immaterial. *See Electric Power and Light Corp., supra,* at p. 83. The primary question is whether the offer of settlement gives fair and equitable recognition to the injuries suffered by Arknat and the public Class A stockholders as a class. We think the form of the instant settlement is appropriate.

[66]Arknat's actual or potential tax liability resulting from the proposed settlement payments to its junior security holders is, in our opinion, irrelevant in determining whether the settlement is fair and equitable.

ous contentions made with respect to them. We have found that a number of the claims have little or no merit, while others have substantial merit. It is our judgment that the proposed settlement contained in the plan falls within the range of fairness both with respect to the aggregate payment of $4,069,268.75 to be made to the public common and Class A stockholders and the differentiation of treatment as between the two classes of security holders. The proposed payments of $1.50 per share to the Class A and 25¢ per share to the common stockholders represent compensation for the corporate claims at the rate of 25¢ per share for each class of stock or $804,055 which, translated into terms of direct recovery by Arknat as a corporation, would be equivalent to a direct payment by Cities to Arknat of approximately $1,900,000,[67] and compensation to the Class A stock of $1.25 per share, or an aggregate of $3,265,213.75, for the special class equities of the Class A stock. Further, the formula in the plan for excluding from participation in the settlement those who, along with Cities, shared the responsibility for the organization, initial financing, and subsequent management of Arknat, is appropriate and fair and equitable.

We conclude that the proposed settlement represents a fair compromise of the issues and may be approved under the standards of Section 11(e).

Other Matters Considered

1. The plan provides that Arknat will pay such fees and expenses for services rendered (except in connection with the refinancing of Arkla, which will be paid by Arkla) as

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[67]Cities, by virtue of its holdings of 51% of Arknat's common and Class A stocks, would in effect participate to that extent in any payment made directly to the subsidiary on account of corporate claims.

we may approve. We do not now have before us any requests for fees and expenses with respect to the plan. Our order herein approving the plan will reserve jurisdiction over the payment by Arknat, Arkla and Cities of fees and expenses in connection with the plan and these proceedings.

2. Consummation of the plan is subject to the approval of an appropriate United States District Court, and Arknat and Cities have requested that we apply to an appropriate court to enforce and carry out the plan in the event that it is approved. In accordance with such request, application will be made to an appropriate court following the issuance of our order, and our order will provide that it is not to operate as authorizing or directing the consummation of the plan until such court order enforcing the plan has been entered.

3. Arknat and Cities have asked that, in the event we approve the plan, our order contain appropriate recitals pursuant to Section 1808(f) and Supplement R of the Internal Revenue Code. In view of our finding that the plan is necessary under Section 11(b) our order will contain such recitals.

CONCLUSIONS

For the reasons stated above, it is our conclusion that the plan is necessary and fair and equitable to the persons affected by it. Accordingly, we shall enter an appropriate order approving the plan.

Since the Act requires expeditious compliance, it would be inappropriate to delay for 30 days the effective date of our order, and accordingly, we find that good cause

exists for making such order effective immediately upon its issuance.[68]

By the Commission (Chairman Cook and Commissioners McEntire, Rowen and Adams), Commissioner Rossbach not participating.

ORVAL L. DUBOIS,
Secretary.

[68]Consummation of the plan will in any event not be effected immediately after entry of our order, since it is conditioned upon approval by an appropriate court, where the proceedings normally require at least 30 days.

Order Approving Plan

UNITED STATES OF AMERICA

BEFORE THE

SECURITIES AND EXCHANGE COMMISSION

October 1, 1952

IN THE MATTER

of

ARKANSAS NATURAL GAS CORPORATION
CITIES SERVICE COMPANY

(File No. 54-186)

ARKANSAS NATURAL GAS CORPORATION
AND ITS SUBSIDIARIES

AND

CITIES SERVICE COMPANY
Respondents

(File Nos. 59-93 and 70-1804)

(Public Utility Holding Company Act
of 1935)

Arkansas Natural Gas Corporation ("Arknat"), a registered holding company and a subsidiary of Cities Service Company ("Cities"), also a registered holding company, having filed a plan, and thereafter an amendment thereto ("the plan") joined in by Cities, pursuant to Section 11(e) of the Public Utility Holding Company Act of 1935 ("the Act") providing, among other things, for the simplification of Arknat's corporate structure, the separation of Arknat's utility from its non-utility interests, its merger with its

oil subsidiary, and the settlement of claims asserted against Cities and its subsidiaries;

The Commission having by notices and orders dated May 19, 1948, and February 9, 1949, instituted proceedings pursuant to Sections 11(b)(1) and (2), and the Commission having consolidated the proceedings under Sections 11(b)(1) and (2) and 11(e) of the Act;

Public hearings having been held after appropriate notice, at which hearings all interested persons were afforded an opportunity to be heard;

The Commission having been requested to enter an order finding that the plan is necessary to effectuate the provisions of Section 11(b) of the Act and is fair and equitable to the persons affected thereby, and having been requested that such order contain recitals in accordance with the provisions and requirements of the Internal Revenue Code, as amended;

Arknat and Cities having requested the Commission, pursuant to Section 11(e) of the Act, to apply to an appropriate court in accordance with the provisions of subsection (f) of Section 18 of the Act, to enforce and carry out the terms and provisions of the plan; and

The Commission being duly advised, and having this day issued its Findings and Opinion, on the basis of said Findings and Opinion, and pursuant to the applicable provisions of the Act and the Rules and Regulations thereunder

IT IS ORDERED that the said plan be, and hereby is, approved, subject to the terms and conditions contained in Rule U-24 of the General Rules and Regulations promulgated under the Act and to the following additional terms and conditions:

1. The order entered herein shall not be operative to authorize the consummation of the transactions pro-

posed in the plan until a court of competent jurisdiction shall, upon application thereto, enter an order enforcing said plan.

2. Arknat, Arkla, and Cities shall pay only such fees and expenses in connection with the plan and the proceedings relating thereto as the Commission may approve on appropriate application made to it, and jurisdiction is hereby reserved to determine the reasonableness and appropriate allocation of all such fees and expenses.

3. Jurisdiction be and it hereby is further specifically reserved with respect to the following matters:

a. The terms and conditions under which the proposed bonds are to be issued by Arkansas Louisiana Gas Company ("Arkla") and the proposed debentures are to be issued by Arknat;

b. The selection and composition of the first boards of directors of Arkla and of Arkansas Fuel Oil Corporation ("Fuel Oil") upon or after consummation of the plan;

c. The resolution of the problems presented by the continued existence of a minority public interest in Fuel Oil after consummation of the plan;

d. The amendment of Arkla's charter to require an affirmative vote of two-thirds of the stock to amend provisions of such charter granting cumulative voting privileges in the election of directors and conditional pre-emptive rights, and its amendment in such other respects as may be appropriate for the protection of investors; and

e. The entertaining of such further proceedings, entering of such further orders and the taking of

such other action as may be necessary or appropriate to effectuate the provisions of Section 11(b) of the Act and as may be appropriate in connection with the plan, the transactions incident thereto and the consummation thereof.

IT IS FURTHER ORDERED AND RECITED and the Commission finds that

(1) the issuance and sale by Arknat of $23,000,000 principal amount of its 20-year sinking fund debentures and the exchange of Arknat preferred stock by the holders thereof other than Cities for such debentures, with such cash adjustments as may be appropriate, and the surrender to Arknat by Cities of its holdings of 870,812 shares of the preferred stock of Arknat for retirement and the receipt by Cities in payment therefor of the sum of $10.60 per share, together with an amount equal to unpaid dividends to the date specified for such payment;

(2) the change of the presently outstanding 298,988 shares of common stock of Arkla into 3,801,609 shares of common stock of Arkla of the par value of $5 per share, and the distribution of such common stock by Arknat to the holders of its common and Class A stock on the basis of one-half share of such common stock of Arkla for each share of common or Class A stock of Arknat, and the distribution by Arknat to such holders of registered or bearer scrip certificates in lieu of fractional interests in such common stock of Arkla, and the distribution by Arknat of full share certificates of such common stock of Arkla in exchange for such scrip certificates when combined in proper amounts and presented at the proper time; and

(3) the merger of Arkansas Fuel Oil Company into Arknat, which will continue as the surviving corpora-

tion with the change of its name to Fuel Oil and, as part of such merger, the conversion of the outstanding 3,522,271¼ shares of Class A stock and the outstanding 4,080,801 shares of common stock of Arknat, together with 147 shares of common stock of Arknat held in reserve for exchange for common stock of a predecessor company, into 3,801,609 shares of common stock of the par value of $5 per share of Fuel Oil in the ratio of one-half share of such common stock of Fuel Oil for each of said shares of Class A stock and common stock of Arknat, and the issuance of registered or bearer scrip certificates in lieu of fractional interests in such common stock of Fuel Oil and of full share certificates of such common stock in exchange for such scrip certificates when combined in proper amounts and presented at the proper time,

all as provided in the plan approved herein, are necessary and appropriate to the integration and simplification of the holding company system of which Cities, Arknat, Arkla and Arkansas Fuel Oil Company are members, and are necessary and appropriate to effectuate the provisions of Section 11(b) of the Act within the meaning of Sections 371, 373(a) and 1808(f) of the Internal Revenue Code, as amended.

By the Commission.

ORVAL L. DUBOIS
Secretary

STATUTE INVOLVED

The pertinent sections of the Public Utility Holding Company Act of 1935, 49 Stat. 803, 15 U. S. C. 79, *et seq*, are as follows:

Section 2(a):

(a) When used in this chapter, unless the context otherwise requires—

* * *

(5) "Public-utility company" means an electric utility company or a gas utility company.

* * *

(7) "Holding company" means—

(A) any company which directly or indirectly owns, controls, or holds with power to vote, 10 per centum or more of the outstanding voting securities of a public-utility company or of a company which is a holding company by virtue of this clause or clause (B) of this paragraph, unless the Commission, as hereinafter provided, by order declares such company not to be a holding company;

* * *

(9) "Holding-company system" means any holding company, together with all its subsidiary companies, and all mutual service companies (as defined in paragraph (13) of this subsection) of which such holding company or any subsidiary company thereof is a member company (as defined in paragraph (14) of this subsection).

* * *

(12) "Registered holding company" means a person whose registration is in effect under section 5 of this Act. [15 U. S. C. 79b].

* * *

Section 3(a):

(a) The Commission, by rules and regulations upon its own motion, or by order upon application, shall exempt any

holding company, and every subsidiary company thereof as such, from any provision or provisions of this chapter, unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers, if—

* * *

(5) such holding company is not, and derives no material part of its income, directly or indirectly, from any one or more subsidiary companies which are, a company or companies the principal business of which within the United States is that of a public-utility company. [15 U. S. C. 79c].

* * *

Section 11(b):

(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

* * *

(2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. * * * Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company. [15 U. S. C. 79k].

* * *

Clerk, Supreme Court, U.S.
FILED
Clerk

IN THE

Supreme Court of the United States

October Term, 1957

No. 602

CITIES SERVICE COMPANY,
Petitioner,

against

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

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STATUTE:

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IN THE

Supreme Court of the United States

October Term, 1957

CITIES SERVICE COMPANY, *Petitioner,* —*against*— SECURITIES AND EXCHANGE COMMISSION, *Respondent.*	No. 602

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

I

It was urged in the petition for a writ of certiorari that the decision below should be reviewed by this Court because that decision expands Commission power under Section 11(b)(2) of the Public Utility Holding Company Act of 1935 in a way drastically inconsistent with the intent of Congress, decisions of this Court and decisions of the Commission, both in this case and in other cases. The briefs in opposition* seek to avoid those issues by urging (SEC

*Although it seems unlikely that certain intervening respondents below have any standing in this Court [*cf. Boston Tow Boat Co. v. United States*, 321 U. S. 632], those intervenors nonetheless have filed a brief in opposition.

Br. 10, 12, 15-17; Penn. Br. 5-8*) that the decision below must be correct because the Commission has found, and Cities does not deny, that intra-system business dealings between a parent and its subsidiary can give rise to conflicts of interest in the resolution of which the minority cannot outvote the majority shareholders. That so-called "finding of fact" (SEC Br. 12; Penn. Br. 5-8) is, of course, one that is logically ineluctable in any legal system that envisages subsidiaries that are not wholly owned.** The decision below, which declares such parent-subsidiary arrangements illegal under Section 11(b)(2) of the Act is without precedent and is obviously important. Furthermore, legal issues respecting the interaction of Section 11(b)(2) with Section 11(e) and Sections 12 and 13 of the Act are clearly raised in this case. Resolution of those problems by this Court is obviously important to proper administration of the Public Utility Holding Company Act.

II

The Commission in its opposition (SEC Br. 12-13) contends that Cities is estopped from objecting to the decision below. It urges that Cities is estopped, because had the Company, in 1952,

*References to pages in opposition filed by The Pennroad Corporation, Louis E. Marron, James W. Hearn, et al., will be cited as "Penn. Br. . . . . ."

**Cities has contended before the Commission, the court below and in its petition to this Court that there is nothing in Section 11(b)(2) of the Public Utility Holding Company Act that makes parent-subsidiary relationships and dealings illegal merely because majority-minority interests co-exist in the subsidiary. That contention is the nub of this case. Cities believes that position to be particularly correct where, as here, there is no contention, following examination by an expert commission of "a detailed record of the relationships and dealings between" Cities and Fuel Oil, of any overreaching or spoliation (SEC Br. 10; App. 44a; R. 24a). *Cf. Comstock* v. *Group of Investors*, 335 U. S. 211.

> "... repudiated the jurisdiction reserved in the Commission's order, the Commission surely would not have made the necessary District Court application and the plan would have died a-borning." (SEC Br. 12)

That contention deserves reply, for the facts brutally belie the argument.

The Plan was submitted to the District Court in 1952 under the procedures of Section 11(e) of the Act. Those procedures charge the Commission to

> (1) review each proposed reorganization plan submitted by a registered holding company or subsidiary thereof,
>
> (2) approve such plan as submitted or modified by the submitting company, if the plan is [i] fair and equitable and [ii] necessary to effectuate the provisions of Section 11(b)(2), and
>
> (3) apply to a court (but only "at the request of the company") to enforce and carry out the terms of the plan thus approved.*

The Plan for the reorganization of Arknat [predecessor of Fuel Oil] was submitted to the Commission by Arknat and Cities (App. 52a). The Plan expressly contemplated that with its consummation the new company thereby created, *i.e.*, Fuel Oil, would be in full compliance with Section 11(b). Finally, the application for approval (R. 23b, 24b), which was submitted to the Commission with the Plan, requested that the Commission should apply to a District Court for an appropriate order of enforcement, *but only if the Commission approved the Plan*. That was the request for enforcement upon which the Commission acted.

*For the full text of Section 11(e), see the Appendix to this brief.

In recognition of the fact that the Plan contemplated full compliance with Section 11(b) the Commission ordered hearings that would raise for consideration the following matters and questions:

> "1. Whether the Plan, as submitted or as it may hereafter be modified, is necessary to effectuate the provisions of Section 11(b) of the Act and is fair and equitable to the persons affected thereby.
>
> "2. Whether the Plan achieves the statutory requirements with respect to corporate simplification of the Arkansas-Natural system and with respect to fair and equitable distribution of voting power among the security holders of Arkansas-Natural." (R. 23b)

On October 1, 1952, the Commission issued its findings, opinion and order, approving the Plan (App. 48a-70a). The Commission simultaneously (*i.e.*, on the same day, and before Cities or Arknat had seen any portion of the findings, opinion and order, including the so-called reservation of jurisdiction) submitted the Plan to the District Court for enforcement. To justify that submission, the Commission had to, and did, rely upon the request for enforcement contained in the application for approval which had accompanied the Plan. Throughout the District Court proceedings on the Plan, the Commission never intimated to Cities, to Arknat or to the District Court that Commission approval of the Plan had been anything less than the approval contemplated at the time the Plan was filed and upon which the request to the Commission to apply for court enforcement was predicated. The Commission certainly did not intimate, as it now contends (SEC Br. 8), that it was approving the Plan in part and disapproving it in part.*

*Had the Commission ever so intimated the Plan certainly "would have died a-borning", because consummation of the Plan not only has involved great expense to Cities but has foreclosed to it other methods of compliance, drastically changing Cities' position for the worse.

At no time during the 1950-1952 hearings on the proposed Plan did the Commission or its staff express doubt that the methods proposed therein would effectuate the fair and equitable distribution of voting power required by Section 11(b)(2). Indeed, the findings and opinion of the Commission clearly indicate that in 1952, when approving the Plan, the Commission intended that consummation of the Plan would place the predecessor of Arknat, *i.e.*, Fuel Oil, in full compliance with Section 11(b)(2). It is impossible to read the following language of the findings and opinion and not so conclude:

> "These proceedings involve an amended plan filed pursuant to Section 11(e) of the Public Utility Holding Company Act of 1934 ("the Act") by Arkansas Natural Gas Corporation ("Arknat") and its parent, Cities Service Company ("Cities"), both registered holding companies. The plan, . . . is proposed as a means of complying with Sections 11(b)(1) and 11(b)(2) of the Act. . . .
>
> ". . .
>
> "2. Consummation of the plan is subject to the approval of an appropriate United States District Court, and Arknat and Cities have requested that we apply to an appropriate court to enforce and carry out the plan in the event that it is approved. In accordance with such request, application will be made to an appropriate court following the issuance of our order, and our order will provide that it is not to operate as authorizing or directing the consummation of the plan until such court order enforcing the plan has been entered. (App. 50a, 64a)

As the above-quotation shows, the Commission, of course, was aware that under Section 11(e) it had a right to go to the District Court only if requested by the companies that had submitted the Plan. When the Commission relied for enforcement of the Plan upon the request of Cities

and Arknat, Cities could properly, and did, assume that the reservation of jurisdiction contained in the Commission order approving the Plan did not modify the Plan so as to deprive Arknat (*i.e.*, Fuel Oil) of that full compliance with Section 11(b)(2) which clearly had been contemplated when the Plan was submitted. Unless that were so, the Commission could not legally, under Section 11(e), have submitted the Plan for enforcement, having materially modified the Plan without the consent of its sponsors.

The failure of the Plan to make provision for the elimination of the minority interest was referred to by the Commission only as an objection by a committee representing certain minority stockholders of Arknat (App. 54a, 58a-59a). Had that objection to the Plan been regarded by the Commission as raising questions as to whether the Plan fully remedied the outstanding inequitable distribution of voting power or whether it would be unfair and inequitable to the persons affected thereby, the Commission would have had to decide those questions then and there. To have deferred those answers until after consummation of the Plan would have been to reserve jurisdiction to determine, after the Plan had been consummated, the very questions that had to be determined before the Plan could be approved, *i.e.*, whether the Plan provided an appropriate method for compliance with the provisions of Section 11(b)(2) and whether it was fair and equitable to the persons affected thereby. Unless the distribution of voting power provided by the Plan was determined by the Commission to be fair and equitable, it is clear that the Plan could not have provided an appropriate method of compliance with Section 11(b)(2) nor have been deemed fair and equitable to the persons it affected. Moreover, if it had been marked with those defects which the Commission now suggests, it could not have been approved in 1952 as a plan "necessary" under Section 11(b).

Respondents have refused to meet this argument. They have hinted, to be sure, that this case can somehow be brought within the practice of the Commission which on occasion permits step-by-step compliance with Section 11(b)(2). But this is not such a case. Indeed, there is no case where the Commission ever has used the step-by-step technique to bring a single security (here Arknat common stock) into compliance with Section 11(b). And certainly there is no case in which the Commission ever has tried to use the step-by-step technique to move first one step forward, then one step back. That is not the way of the law, but of the minuet.

Arknat and Cities never sought permission of the Commission to make step-by-step compliance with Section 11(b)(2). The Plan was presented to the Commission as a method of effectuating full compliance. If, as respondents now contend, the distribution of voting power provided by the Plan *per se* effected an inequitable distribution as to the minority stockholders, then in 1952 the Plan must have been unfair and inequitable to those stockholders and must not have provided an appropriate method of effectuating compliance with Section 11(b)(2). Of course, if that had been the case, the statutory findings required by Section 11(e) could not have been made. The proposed Plan would have had to be disapproved, therefore, exactly as was done in *Federal Water Service Corporation*, 18 S.E.C. 231, *affirmed, Securities and Exchange Commission* v. *Chenery Corporation*, 332 U. S. 194.*

*It is erroneous, of course, to suggest, as does the Commission (SEC Br. 12-13), that

> ". . . if the Commission had found in 1952 that the Plan had effected full compliance with Section 11(b)(2), . . . the reservation of jurisdiction and the condition would have had no purpose."

The Commission has power over registered holding companies, *inter alia*, under Sections 3, 5, 12 and 13 of the Act, and in the context of

In this case, however, the Commission approved the Plan; it had the Plan enforced; and now, after enforcement and consummation, it declares that the distribution of voting power provided therein is inequitable to the minority stockholders. That finding squarely contradicts and reverses the earlier Commission conclusion. The most that now can be said for the Commission is that it has had a change of mind. But, as this Court held in *Mine Workers* v. *Eagle-Picher Co.*, 325 U. S. 335, an administrative body has no power to exercise its admittedly wide discretion a second time in disregard of a previous order to which legal sanction has been imparted by court order.

III

Somewhat related to its estoppel argument is the statement of the Commission that not until 1955 did it develop

> ". . . a detailed record of the relationships and dealings between petitioner and Fuel Oil." (SEC Br. 10)

To that there is a short answer. The records in the 1950-1952 and the 1955-1956 proceedings relating to intra-system dealings by Fuel Oil, apart from increments to statistics due to the passage of a few years, are so nearly congruent in terms of the issues raised and explored as to be almost indistinguishable. The Commission in 1952, when it approved the Plan, had facts covering many years of Fuel Oil operation under the so-called hypothetical refinery con-

---

the objections raised to the Plan, in 1950-1952, by the stockholders' committee, it was appropriate expressly to retain jurisdiction over Cities and Fuel Oil for the purpose of exercising such powers. That is what the Commission in 1952 conceived itself to be doing. That is what Cities understood the Commission to be doing. That is what this Court should hold the Commission to have done.

tract. The Commission had heard argument from every quarter concerning that arrangement. The Commission now does not contend that any change in the relationships occurred between 1952 and 1956. If, as this Court held in the *Eagle-Picher* case [325 U. S. 335], an administrative agency may not avoid the consequences of its final orders because it subsequently becomes aware for the first time of pertinent facts, it follows, *a fortiori*, that the Commission here cannot avoid the impact of the 1952 order of enforcement by saying that four years thereafter it had collected a more imposing array of facts bearing upon those issues that it had already decided.

CONCLUSION

The decision of the court below is the first which holds that the Commission may enter

> ". . . an order under Section 11(b) mandatorily requiring [the elimination of a minority interest] against the desires of management where the existence of the minority interest and the related business relationships have been the sole basis for action under Section 11(b)." (Reply Brief of Division of Corporate Regulation of the Securities and Exchange Commission, dated December 1, 1955, Dock. No. 31, p. 9)

Equally important is the clear implication in this case that an administrative agency is privileged to enter successive and conflicting orders with respect to the same subject matter.

There is no doubt that the holding will seriously affect administration of the Public Utility Holding Company Act. It may have even greater effect upon administration of the

regulatory process generally. It should be reviewed by this Court.

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December 27, 1957.

APPENDIX

Section 11(e) of the Act reads:

"In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed."

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IN THE

Supreme Court of the United States

October Term, 1957

No. 602

CITIES SERVICE COMPANY,
Petitioner,

against

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

JOINT BRIEF FOR INTERVENING RESPONDENTS THE PENNROAD CORPORATION, LOUIS E. MARRON, JAMES W. HEARN *ET AL.*, IN OPPOSITION

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JOINT BRIEF FOR INTERVENING RESPONDENTS THE PENNROAD CORPORATION, LOUIS E. MARRON, JAMES W. HEARN *ET AL.*, IN OPPOSITION

Preliminary Statement

This brief is submitted by respondents The Pennroad Corporation, Louis E. Marron, James W. Hearn, Paul S. Hearn, William J. Hearn and Eleanor Hearn, members of the public minority stock interest in Arkansas Fuel Oil Corporation (Fuel Oil) in opposition to Cities Service Company's (Cities) petition for a writ of certiorari.

Opinion Below

The opinion of the Court of Appeals, dated July 15, 1957, is officially reported at 247 F. 2d 646 (3a-18a). The findings and opinion of the Securities and Exchange Com

mission (Commission), dated August 31, 1956, have not been officially reported, but are set forth in Holding Company Act Release No. 13254 (19a-47a).

Jurisdiction

The judgment of the Court of Appeals was entered August 14, 1957 (1a-2a). Petitioner invokes the jurisdiction of this Court under Section 24 of the Public Utility Holding Company Act of 1935, 15 U. S. C. 79x(a) and under 28 U. S. C. 1254(1).

Statute Involved

The statute involved is Section 3(a) and Section 11 of the Public Utility Holding Company Act of 1935 (Act).

Question Presented

Where, after extensive hearings, the Commission finds,

(1) that Fuel Oil, a registered holding company and a subsidiary of Cities, also a registered holding company, is an integral and indistinguishable part of the integrated Cities system, so that all decisions are made for Fuel Oil at the Cities level,

(2) that the public minority stockholders of Fuel Oil, who can only vote at the departmental and not the Cities level, are in fact disenfranchised, and

(3) that the system level determinations by Cities involve conflicts of interest between the Cities system and Fuel Oil to the detriment of the public minority stockholders of Fuel Oil,

is it within the power of the Commission to find that there is present an inequitable distribution of voting power within the meaning and intent of Section 11(b)(2) of the Act, and therefore deny Cities' application for an exemp-

tion from the provisions of the Act that would terminate the Commission's power to require correction of the statutory violation?

Statement

The judgment sought to be reviewed affirmed an order of the Commission denying Cities' application for an exemption from the provisions of the Act. At the direction of the Commission the proceedings to consider that application were consolidated with then pending proceedings under Section 11(b)(2) and Section 11(c) of the Act affecting Cities and Fuel Oil (21a).

The reason for the consolidation was that in the prior proceedings under Sections 11(b)(2) and 11(c) the Commission had *conditionally* approved a plan filed by Cities and Fuel Oil, designed to effect compliance by Fuel Oil with the provisions of the Act. The condition was occasioned by the finding by the Commission that under the plan there would continue to be a public minority stock interest in Fuel Oil and that its existence presented a problem which might require corrective action (58a). The Commission stated that it would consider that problem at a later date and therefore "subject to the reservations noted" approved the plan as an appropriate means for achieving the results required by Section 11(b) (59a). In its order approving the plan, therefore, the Commission expressly reserved jurisdiction with respect to the resolution of the problems presented by the continued existence of a minority public interest in Fuel Oil and to entertain such further proceedings and to enter such further orders as might be necessary or appropriate to effectuate the provisions of Section 11(b) of the Act (68a, 69a).

Since the Commission expressly stated that by reason of the public minority it could only conditionally approve the Plan as an appropriate means for achieving the results required by Section 11(b) (59a) and reserved jurisdiction to enter further orders under Section 11(b) (68a), obviously there is no merit in Cities' contention that the Commission had not indicated that the public minority interest might present an 11(b)(2) problem (27a-30a).

If Cities' application for an exemption were granted, the Commission would no longer have the power to deal with the problems posed by the public minority pursuant to Section 11(b) of the Act and its reservation of jurisdiction would have been rendered futile. Accordingly the Commission directed a consolidation of the proceedings arising from Cities' exemption application with the 11(b)(2) and 11(c) proceedings so that the application for exemption could be considered in relation to the unresolved 11(b)(2) and 11(c) proceedings.

Thereafter, after extensive hearings in the consolidated proceedings, the Commission found, factually, that the situation of Fuel Oil in the context of the Cities system was such that the public minority stock interest in Fuel Oil was effectively disenfranchised. The Commission held that, in consequence, there was an inequitable distribution of voting power within the meaning of Section 11(b)(2) of the Act which precluded the granting of an exemption and for that reason entered an order denying Cities' application.

Upon petition to review to the Court of Appeals for the Second Circuit, that Court held that there was "ample support in fact and common sense for the conclusions of the Commission that there were inherent conflicts of interest and the *de facto* disenfranchisement of the minority interest. On this record the Commission was justified in refusing to grant exemption to Cities until Fuel Oil eliminated the minority interest" (18a).

ARGUMENT

Summary of Argument

(1) The question posed in the petition is not, in fact, presented by this record.

(2) The inequitable distribution of voting power, here found to be present, constitutes a violation of Section 11(b)(2) of the Act that empowers the Commission to require remedial action.

POINT I

The question stated in the petition is not presented by the record.

Cities has abandoned the legal contention it advanced in the Court of Appeals, an asserted lack of jurisdiction of the Commission over Cities and Fuel Oil because both companies had theretofore disposed of their domestic utility properties. On this legal issue the Court below ruled against Cities, expressly concurring with a prior determination of the Court of Appeals for the Third Circuit in *In re United Corporation*, 232 F. 2d 601, which this Court declined to review (352 U. S. 839).

Instead, Cities now asks this Court to issue a writ to review a factual conclusion of the Commission, a conclusion for which the Court of Appeals found there was "ample support in fact and common sense" (18a). The Commission found that Fuel Oil is so intimately tied to the Cities System by a multiplicity of affiliations and intra-system transactions that, operationwise, it has been assimilated into and, for all practical purposes, is a part of the Cities System (35a), so that the public minority stockholders of Fuel Oil, who have no vote in selecting the system managers, were effectively disenfranchised (46a), and finally, the Commission found that the system decisions, which determine the operations of Fuel Oil, continuously involve a conflict of interest between the Cities system on the one hand and Fuel Oil on the other, at least in so far as its impact on the minority stockholders of Fuel Oil is concerned (45a).

Obviously, this Court is not concerned with reviewing such factual conclusions of an administrative agency (*Securities and Exchange Com.* v. *Chenery Corp.*, 332 U. S. 194, 204, 208, 209; *Securities and Exchange Com.* v. *Central-Ill. Sec. Corp.*, 338 U. S. 96, 127).

In order, however, to induce this Court to issue a writ, Cities attempts to pose the question presented as though it

were one of law, as though the Commission had held that in every case, where there are any business relations between a subsidiary of a registered holding company and another subsidiary in which there is a public minority interest, that, in and of itself, constitutes a violation of Section 11(b)(2) of the Act (pet. p. 2).

Upon this false premise Cities urges that the question is one of importance since there are many public utility holding companies that have subsidiaries with a public minority interest (pet. p. 19) and that the Commission's decision in the instant case conflicts with its ruling in many prior instances in which it permitted the continuance of a public minority interest.

That the question posed is not here presented is evidenced by the findings and opinion of the Commission and the opinion of the Court of Appeals. There was no ruling that whenever there are any business relations between two subsidiaries of a registered holding company, in one of which there is a public minority interest, there is present a violation of Section 11(b)(2). The holding of the Commission goes no further than to say that when it is shown that a subsidiary in which there is a public minority interest is so interwoven into a system operation that except on paper there is no such thing as the subsidiary enterprise, the public that owns a minority interest in this indistinguishable segment of an integrated system is, in fact, disenfranchised, and when a review of the dealings between the parent and subsidiary evidences conflicts between the interests of the system operation and those of the subsidiary to the detriment of the public minority stockholders in the subsidiary, there is present an inequitable distribution of voting power in violation of Section 11(b)(2) of the Act. That such, and such only, was the determination of the Commission, that it stated no blanket legal principle, is evidenced not only by the findings and opinion of the Com-

mission and the opinion of the Court of Appeals but by the fact that some 2,000 pages of testimony were required to develop the facts of this situation and of this situation alone.

The Commission, in 1952, when it approved the plan of reorganization submitted by Cities and Fuel Oil subject to the express reservation that it would subsequently inquire into the 11(b) implications of the presence of a public minority interest in Fuel Oil (58a, 59a), was then well aware that there was a public minority in a subsidiary of Cities and that this subsidiary had some intercorporate relations with other subsidiaries of Cities. Had this alone sufficed for a determination that there was a violation of Section 11(b)(2), the Commission would have so declared. What it did, however, was to hold merely that the minority interest presented a problem "which may require corrective action" (58a).

The Commission thereafter required hearings to be held and only after consequential disclosure that there was not only a minority interest in the subsidiary but also a complete assimilation of the subsidiary into the system, accompanied by conflicting interests and resulting in effective disenfranchisement, did it conclude that there was here present an inequitable distribution of voting power in violation of Section 11(b)(2).

Indeed, the cases in which the Commission permitted the continuance of a public minority interest establish, not that the Commission has reversed itself, as Cities would contend, but that as the Commission stated, "whether the presence of a minority interest involves a detriment which the statute seeks to prevent must, of course, be resolved on the facts in each case" (34a, 35a). Since the issue is a factual one, we find that, as in some instances the Commission has permitted the continued existence of a public minority, in many other cases it has held that the subsidiary is so integral a part of the integrated system operation that

there is effective disenfranchisement within the prohibition of Section 11(b)(2).[2]

We submit that the factual conclusion arrived at by the Commission, on the basis of an extensive record and as a result of its expert experience in the administration of the Act, a conclusion in which the Court of Appeals concurred, does not require review by this Court.

POINT II

The inequitable distribution of voting power here found to be present constitutes a violation of Section 11(b)(2) of the Act that empowers the Commission to require remedial action.

In the informed judgment of the Commission, the public minority in Fuel Oil is effectively disenfranchised; it has, in reality, no vote. This factual conclusion was affirmed by the Court of Appeals. Necessarily, therefore, since some of the security-holders in the holding company system are disenfranchised, there is an inequitable distribution of voting power. Cities urges, however, and would have this Court issue a writ to consider its contention, that the Commission is powerless to remedy the condition for the reason that the inequitable distribution of voting power here present does not arise by reason of (1) the corporate structure or (2) the continued existence of Fuel Oil, and only an inequitable distribution of voting

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[2] *Southern Natural Gas Company et al.*, 34 S. E. C. 718, 726-727 (1953); *Alabama Power Company et al.*, 34 S. E. C. 219, 224-225 (1952); *United Gas Improvement Company et al.*, 33 S. E. C. 729, 738 (1952); *American Gas and Electric Company*, 32 S. E. C. 130, 141-142 (1950); *Southern Company et al.*, 31 S. E. C. 821, 834 (1950); *Sioux City Gas and Electric Company et al.*, 30 S. E. C. 5, 14-15 (1949); *Electric Power & Light Corporation et al.*, 29 S. E. C. 52, 65 (1949). See also *Georgia Power and Light Company et al.*, 18 S. E. C. 89, 103-104 (1945).

power, however improper, produced by those causes alone, may be corrected by the Commission (pet. pp. 9-12).

We submit that the statutory power of the Commission is not to be so restricted. Congress has charged it with "the duty * * * to examine * * * the relationships among the companies in the holding-company system of every such company and the character of the interests thereof * * * to determine the extent to which * * * voting power [may be] fairly and equitably distributed among the holders of securities thereof * * * " (Sec. 11(a)).

But again Cities is posing problems that are not presented by the record. Even assuming that the Commission's power to correct an inequitable distribution of voting power is limited to those situations where such an inequity is caused by the corporate structure or continued existence of any company, we find that cause present here on both counts. The corporate structure of the holding company system on a consolidated basis includes and reflects the presence of a public minority interest in Fuel Oil. It is that portion of the corporate structure that occasions the inequitable distribution of voting power. It is within the power of the Commission, under the express language of Section 11(b)(2), however restricted a meaning be given to it, to correct that corporate structure in order to ensure an equitable distribution of voting power.[3]

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[3] Cities' contention respecting restrictions on the Commission's power by reason of the language of the third sentence of Section 11(b)(2) is wholly irrelevant. By its express terms the restriction in no event applies when the purpose is to "fairly and equitably distribute voting power among the security holders of such company". Here the purpose is to effect a fair and equitable distribution among the security holders of Fuel Oil. Moreover the limitation is confined to operating companies and Fuel Oil is a registered holding company. Cities' point that Fuel Oil is a registered holding company but not a holding company, and therefore the Commission has only a restricted jurisdiction over it, is an attempt at semantic gymnastics that does not even have a specious appeal.

Moreover, this case clearly comes within the second stated cause. The statute requires the Commission to see to it that the "continued existence of any company *in the holding company system*" does not unfairly or inequitably distribute voting power among securityholders of such holding company system. It is pointless for Cities to seek to avoid the impact of this provision with the statement that neither the Commission nor the Court of Appeals held that the "continued existence" of Fuel Oil results in "an inequitable distribution of voting power" (pet. p. 9). The whole thrust of the Commission's findings and opinion is that the continued existence of Fuel Oil in the holding company system, as Fuel Oil is presently constituted, results in an inequitable distribution of voting power. Thus it is the directive of the Commission that Fuel Oil, as it is presently constituted, cannot continue to exist in the holding company system. And this divorcement is to be effected either through Cities' disposing of its majority interest in Fuel Oil, at which point Fuel Oil would no longer be a part of the system; or, alternatively, through Cities acquiring the minority interest, at which point, while Fuel Oil would remain part of the system, it would not continue its existence in the system, as it is presently constituted (46a).

So we find both the statutory evil, an inequitable distribution of voting power, and the designated statutory cause of that evil, the continued existence, as it is presently constituted, of Fuel Oil in the holding-company system.

Conclusion

The Commission, affirmed by the Court of Appeals, has found as a fact that in the instant situation there is an inequitable distribution of voting power within the prohibition of Section 11(b)(2) of the Act. The questions posed in the petition are not presented by the record and such issues as are presented do not warrant review by this Court.

The intervening respondents respectfully pray that the petition for a writ of certiorari be denied.

Dated: December 6, 1957.

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No. 502

In the Supreme Court of the United States

OCTOBER TERM, 1957

CITIES SERVICE COMPANY, PETITIONER,

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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Miscellaneous:

Greidinger, *Preparation and Certification of Financial Statements* (1950)	15
Kennedy and McMullen, *Financial Statements* (1952)	15
Lewis, *Consolidated Statements* (1942)	15
Nixon and Kell, *Accountants' Hand Book*, 4th ed. (1956)	15
Securities and Exchange Commission Accounting Series Release No. 7 (1938)	15
Securities and Exchange Commission Regulation S-X, Rule 4-07	15

In the Supreme Court of the United States

OCTOBER TERM, 1957

No. 602

CITIES SERVICE COMPANY, PETITIONER,

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 247 F. 2d 646 (App. 3a).[1] The Findings and Opinion and Order of the Securities and Exchange Commission ("Commission") are set forth in Holding Company Act Release No. 13254 (App. 19a).

JURISDICTION

The opinion of the Court of Appeals was entered July 15, 1957, and its judgment was entered on August

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[1] References to pages in the appendix filed by petitioner will be cited as "App. ——".

14, 1957 (App. 1a). The petition for a writ of certiorari was filed on November 8, 1957. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

Relevant provisions of the Public Utility Holding Company Act of 1935, 49 Stat. 803, 15 U.S.C. § 79, *et seq.*, are set forth in the appendix to the petition at pages 71a-72a.

QUESTION PRESENTED

Section 3(a) of the Public Utility Holding Company Act of 1935 authorizes the Commission to exempt a holding company from the requirements of the Act under certain conditions "unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors * * *" In the instant case, the Commission held that this proviso barred the exemption sought by petitioner, a registered holding company system, in view of the Commission's findings (*inter alia*) that the public minority stockholders of a subsidiary registered holding company are as a practical matter disenfranchised and that this disenfranchisement resulted in an "inequitable distribution of voting power" in violation of Section 11(b)(2) of the Act.

The question presented is whether the court below, in the particular circumstances of this case, erred in sustaining the Commission's denial of the exemption sought by petitioner.

STATEMENT

Petitioner, a holding company registered under the Public Utility Holding Company Act of 1935, seeks review of a judgment of the Court of Appeals for the

Second Circuit affirming an order of the Commission denying an application pursuant to Section 3(a)(5) requesting, on behalf of petitioner and its subsidiaries, an exemption from the provisions of the Act. The order was entered in consolidated proceedings involving (a) the exemption application and (b) an issue previously reserved by the Commission in proceedings under Section 11 of the Act concerning a 48.5% publicly held interest in the common stock of Arkansas Fuel Oil Corporation ("Fuel Oil"), a registered holding company subsidiary of petitioner (App. 21a).

The Commission found that the public minority interest in Fuel Oil constitutes a "complexity" and results in an unfair and inequitable distribution of voting power in violation of the standards of Section 11(b)(2) of the Act, precluding the grant of an exemption under the "unless and except" clause of Section 3(a), and that this condition could be rectified only by the elimination of the public minority interest or by petitioner's disposition of its interest in Fuel Oil (App. 46a). Accordingly, in an order entered on August 31, 1956, which was affirmed by the court below, the Commission denied the exemption (App. 47a). The Commission, however, withheld entry of an order under Section 11(b)(2) directing remedial action in order to afford the companies a reasonable opportunity to submit an appropriate program of compliance (App. 46a).[2]

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[2] Thereafter, on September 20, 1957, the Commission entered a Section 11(b)(2) order requiring such compliance (Holding Company Act Release No. 13549). Petitioner and Fuel Oil have filed petitions for review of that order in the Court of Appeals for the Third Circuit.

Background

In 1941, petitioner registered as a holding company under Section 5 of the Act, and it is still so registered [3] (App. 5a). It was the top company in a pyramided holding company system comprising 125 companies with extensive utility and non-utility interests and consolidated assets in excess of one billion dollars at December 31, 1941. The system included a number of registered public utility subholding company systems, both foreign and domestic, with consolidated utility assets of $439 million at the end of 1938.[4]

Reorganization of petitioner's system under Section 11(b) of the Act began in 1940 with the institution of proceedings against one of the system's subholding companies and was followed by proceedings against petitioner itself in 1941.[5] In 1944, the Commission, acting under Section 11(b)(1) of the Act,[6] ordered petitioner, which desired to retain its non-utility gas and oil interests, to divest itself of all its utility

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[3] A holding company is defined in Section 2(a)(7) of the Act as a company which directly or indirectly owns or controls 10 percent or more of the voting securities of a public utility company. A public utility company, as defined in Section 2(a)(5), means an electric or gas utility company. A registered holding company is defined in Section 2(a)(12) as a person, which includes a corporation (Section 2(a)(2)), whose registration is in effect under Section 5 of the Act.

[4] *Cities Service Company*, 15 S.E.C. 962, 964-965 (1944); 8 S.E.C. 318, 322 (1940).

[5] Holding Company Act Releases Nos. 1954 (March 4, 1940) and 2867 (July 3, 1941).

[6] Section 11(b)(1) requires that each registered holding company system be limited to a single integrated public utility system, with provision for the retention of additional utility systems and related incidental businesses under certain designated circumstances.

interests.[7] From 1940, more or less continuously until 1954, there followed numerous mergers, consolidations, dissolutions, reorganizations, and property divestments designed to bring the system into compliance with Sections 11(b)(1) and 11(b)(2). As a consequence of these various steps, petitioner now has one public utility subsidiary, a Canadian company, which it is required to dispose of (App. 24a).

One of the registered subholding companies in petitioner's system has been Arkansas Natural Gas Corporation ("Arknat"), the name of which was changed to Arkansas Fuel Oil Corporation ("Fuel Oil") (App. 53a). The principal subsidiaries of Arknat, which itself registered as a holding company in 1938,[8] were Arkansas Louisiana Gas Company ("Arkla"), a gas utility company, and Arkansas Fuel Oil Company ("Arkco"), a non-utility company (App. 51a).

In 1949 the Commission instituted proceedings under Section 11(b)(2) directed to Arknat and its subsidiaries and to petitioner.[8] In 1950, after abandoning an earlier proposal, Arknat filed a plan of reorganization under the Act,[9] and the proceedings on the plan were consolidated with the Section 11(b)(2) proceedings (App. 52a). Following amendment of the plan

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[7] *Cities Service Company*, 17 S.E.C. 5.

[8] *Arkansas Natural Gas Corporation et al.*, Holding Company Act Release No. 8842.

[9] The plan was filed under Section 11(e) of the Act. Under that section a registered holding company and its subsidiaries may submit a plan to the Commission to comply with Section 11(b) of the Act. The Commission is authorized to approve such a plan if it is found to be necessary to effectuate the provisions of Section 11(b) and fair and equitable to the persons affected, and, at the request of the company, the Commission may thereafter apply to a United States district court to enforce and carry out the provisions of a plan thus approved.

by petitioner and Arknat, the Commission in an order of October 1, 1952, approved the plan (App. 66a). The plan was ordered enforced by the United States District Court for the District of Delaware, and that decision was affirmed by the Court of Appeals for the Third Circuit.[10] The plan was subsequently consummated.

The plan provided for: (1) the retirement of Arknat's preferred stock; (2) the merger of Arkco into its parent, Arknat, with the latter's name changed to Fuel Oil; (3) the distribution by Arknat of the common stock of its subsidiary Arkla to the holders of its common stock and Class A stock;[11] (4) the conversion of both the common stock and Class A common stock of Arknat into a new common stock, on the basis of one-half new share for each old share outstanding; and (5) a cash payment aggregating $4,069,268.75 by petitioner to public holders of Arknat's common and Class A stock as a claims settlement (App. 52a-53a).

The Arknat Class A stock had had no vote; petitioner owned 24.3 percent of the 3,522,271 shares outstanding, with the remainder publicly held. The common stock carried all the voting power, and petitioner owned 75 percent of the 4,080,801 shares outstanding, with the balance publicly held. The plan thus substituted one-half a share of new common stock, which carried the sole voting power, for each share of Class

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[10] *Arkansas Natural Gas Corporation et al.*, Holding Company Act Release No. 11511 (October 1, 1952), approved and enforced, 109 F. Supp. 522 (D. Del.), affirmed 204 F. 2d 797 (C.A. 3) certiorari denied *sub nom. Public Common Stockholders Protective Committee* v. *Arkansas Natural Gas Corporation et al.*, 346 U.S. 865.

[11] Petitioner subsequently disposed of the interests in Arkla thus acquired.

A and common stock. As a consequence petitioner received 51.5 percent of the 3,801,536 shares of the new common stock and the other stockholders received 48.5 percent (App. 23a).

The Reservation of Jurisdiction

In the proceedings on the plan, a committee representing Class A stockholders of Arknat had objected to the plan on the ground that it continued and did not eliminate the public minority interest (App. 58a). In connection with this contention, the Commission, in considering whether the plan was an appropriate means for achieving results required by Section 11(b) of the Act, stated in its Findings and Opinion:

> We recognize that the continued existence of a minority interest in Fuel Oil presents a problem which may require corrective action. However, in view of the fact that Fuel Oil will remain under our jurisdiction as long as Cities is a registered holding company (a status which will continue until terminated by us), we believe that consideration of this problem may be deferred until a later date.
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> * * * * *
>
> In view of the foregoing, we find that, *subject to the reservations noted*, the plan provides an appropriate means for achieving the results required by Section 11(b). [Emphasis added; App. 58a-59a.]

In its order the Commission specifically reserved jurisdiction with respect to:

c. The resolution of the problems presented by the continued existence of a minority public interest in Fuel Oil after consummation of the plan;

* * * * * *

e. The entaining of such further proceedings, entering of such further orders and the taking of such other action as may be necessary or appropriate to effectuate the provisions of Section 11(b) of the Act and as may be appropriate in connection with the plan, the transactions incident thereto and the consummation thereof. [App. 68a-69a.]

The Commission followed this course to permit effectuation of the many beneficial features of the plan without the delay that would be entailed in the resolution of the minority interest problem (App. 58a-59a).

Neither petitioner nor Fuel Oil filed a petition for rehearing with the Commission. At the request of petitioner and Fuel Oil, the Commission applied to the District Court to enforce and carry out the plan (App. 67a). Both companies supported the plan; they raised no objection to the reservation of jurisdiction. And the order of the District Court specifically provided for the enforcement of the plan "subject to the terms and conditions of said Order of the Commission."

The jurisdiction retained over Fuel Oil was reaffirmed in 1953 when Fuel Oil filed an application under Section 5(d) of the Act for an order declaring that it was no longer a holding company.[12] This order was entered

[12] Section 5(d) provides that the Commission may terminate the registration of a holding company which has ceased to be such, subject to such terms and conditions as are necessary for the protection of investors.

by the Commission only after Fuel Oil, without objection from petitioner, had supplemented its application with a consent that any order would be without prejudice to the jurisdiction previously reserved by the Commission. The order specifically provided that, with respect to the public minority interest question, Fuel Oil was to be considered a registered holding company.[13]

Petitioner's Exemption Application

On January 14, 1955, petitioner filed its applications for exemption. The Commission consolidated the proceedings on the application and the issue previously reserved in the Section 11 proceedings (App. 21a).

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[13] The order thus stated:

> The Commission finds that • • • [Fuel Oil] has ceased to be a holding company, that it is necessary for the protection of investors that the Commission retain jurisdiction over • • • [Fuel Oil] to the same extent as though it were still in all respects a registered holding company in respect of the matters over which jurisdiction was reserved in the Commission's Order dated October 1, 1952 • • • to the extent that the matters specified therein have not heretofore been disposed of, and that except for such retained jurisdiction the registration of • • • [Fuel Oil] as a holding company should cease to be in effect.
>
> It Is Therefore Ordered, pursuant to the provisions of Section 5(d) of the Act that • • • [Fuel Oil] has ceased to be a holding company and that, subject to the condition prescribed below, the registration of • • • [Fuel Oil] as a holding company shall cease to be in effect; provided, however, that this order shall be subject to the condition which is prescribed as necessary for the protection of investors that the Commission shall retain jurisdiction over • • • [Fuel Oil] in respect of any further proceedings, investigations or orders which the Commission may deem necessary or appropriate pursuant to the reservation of jurisdiction contained in the Commission's Order of October 1, 1952 • • • in the same manner and to the same extent as though • • • [Fuel Oil] were in all respects a registered holding company. [*Arkansas Fuel Oil Corporation*, Holding Company Act Release No. 12166 (October 7, 1953).]

For the first time, there was developed a detailed record of the relationships and dealings between petitioner and Fuel Oil.

On this record, the Commission found that Fuel Oil "has been assimilated into, and for all practical purposes is a part of the Cities oil and gas system" (App. 35a). It further found, referring to specific examples of transactions between petitioner and Fuel Oil, that

> * * * a conflict of interest manifests itself continuously between the Cities system on the one hand and Fuel Oil on the other, at least insofar as its impact on the minority stockholders of Fuel Oil is concerned * * * [App. 45a]

and that this conflict of interest which

> pervades all aspects of dealings between the Fuel Oil system and the Cities system is such that it constitutes a detriment to the interests of the minority stockholders, who are thereby deprived [of] a management conducting Fuel Oil's affairs with an eye single to its own advantage [App. 44a].

The Commission found that in these circumstances the public stockholders of Fuel Oil are disenfranchised as a practical matter (App. 46a).

These findings, as well as all other findings of fact made by the Commission, are not challenged by petitioner.

In affirming the Commission's order, the Court of Appeals agreed that there was ample support "in fact and common sense" for the conclusions of the Commission that as between Fuel Oil and the Cities system

there existed inherent conflicts of interest and that as a practical matter the public minority was disenfranchised (App. 18a). The court stated (App. 15a-16a):

> Because of the majority rule principle, the voting power of a permanent minority can easily be annulled. One reason why the minority is willing to run this risk is the belief that by and large, differences between majority and minority are differences over means rather than ends since the majority is as eager to further the interests of the corporation as the minority. * * * If the majority's basic concern is not for the welfare of the particular corporation but for an interest which may be adverse, there is no common interest and the minority is effectively disenfranchised—its votes are meaningless and it is at the mercy of the majority.[14]

The court held that, on the basis of the record, the Commission was justified in refusing to grant an exemption to petitioner until the minority interest was eliminated (App. 15a-16a).

ARGUMENT

Petitioner has tendered no question requiring review by this Court. The decision of the court below, affirming the Commission's order, is predicated essentially on a factual determination not disputed by petitioner. The decision, moreover, is clearly correct and does not conflict with prior determinations in this proceeding or with decisions of this Court.

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[14] The court found it unnecessary to determine whether a "complexity" also existed.

1. The Commission held that petitioner was not entitled to an exemption, which would have freed the companies involved from complying with Section 11(b)(2) of the Act, because in the circumstances there is a conflict of interest between petitioner and the public minority stockholders of Fuel Oil and because these stockholders are thereby disenfranchised as a practical matter (App. 18a). Petitioner does not challenge this finding of fact. It contends, however, (a) that the Commission is estopped from taking any action to cure this disenfranchisement, with its resulting unfair and inequitable distribution of voting power, because in 1952 the Commission approved the plan of reorganization of Arknat; (b) that the broad remedial provisions of Section 11(b)(2) do not reach this evil; and (c) that the Commission's decision conflicts with its determinations in other proceedings under Section 3(a). None of these contentions is valid.

(a). Petitioner's estoppel argument completely ignores the fact that it accepted the 1952 reservation of jurisdiction—a reservation, moreover, which was reaffirmed in the 1953 status order. Having enjoyed the benefits of the Arknat plan, it is petitioner, and not the Commission or the minority stockholder group, who is estopped. Had petitioner or Fuel Oil repudiated the jurisdiction reserved in the Commission's order, the Commission surely would not have made the necessary District Court application and the plan would have died a-borning.[15] On the other hand, if the Commission had found in 1952 that the plan had effected

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[15] See note 9, *supra*.

full compliance with Section 11(b)(2), as petitioner suggests (Pet. 13), the reservation of jurisdiction and the condition would have had no purpose.

In approving the 1952 plan, the Commission merely held that the absence of any voting power in the Class A stock of Arknat would be remedied by exchanging that stock for a voting security (App. 55a), leaving for later resolution under Section 11(b)(2) the minority interest problem (App. 58a-59a). This was done because of the desirability of permitting consummation of the many beneficial features of the plan, the third in a series of plans in proceedings spanning a four-year period. Section 11, because of the virtual impossibility of effecting full compliance in one omnibus plan, has been consistently administered so as to permit compliance in a series of plans. *Phillips* v. *Securities & Exchange Commission*, 156 F. 2d 606, 609 (C.A. 2). This technique for effecting compliance may not be used, however, as a means of frustrating the achievement of the objectives of Section 11. Before a registered holding company is released from the operation of the statute, it must be purged of those abuses encompassed by Section 11(b)(2). The fact that Fuel Oil (Arknat with its name changed) is no longer in the utility business and Cities is no longer in the domestic utility business is a circumstance stemming from a sequence of steps taken to comply with the statute and does not affect the extent of compliance which must be achieved.[16]

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[16] "It is not the order of consummation of steps in its plan to cease to be a holding company which has major significance." *In re The United Corporation*, 128 F. Supp. 725, 738 (D. Del.), affirmed, 232 F. 2d 601, 605-606 (C.A. 3), certiorari denied, 352 U.S. 839.

(b). Section 11 of the Act has been described as the "very heart of the title".[17] Section 11(b)(2) is a remedial provision designed to simplify corporate structures of registered holding company systems, to provide investors with securities in these simplified structures that carry meaningful rights, and to afford investors protection from abuse. That section requires the Commission to order each registered holding company, and each subsidiary company thereof, to take such steps as the Commission shall find necessary

> to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. [App. 72a.]

Any element of system corporate structure, or the continued existence of any company in the system, which creates a "complexity" or an inequitable distribution of voting power among security holders in the system, falls within the statutory proscription. This is clear from the language of Section 11(b)(2) itself and also from Section 11(a)—a guide giving "meaningful content" to the terms of the latter section[18]—which imposes a duty upon the Commission in connection with its functions under Section 11(b) to examine "the relationships among the companies in the holding-company system * * * and the character of the interests thereof * * *."

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[17] *North American Company* v. *Securities & Exchange Commission*, 327 U.S. 686, 704, note 14.

[18] *American Power & Light Company* v. *Securities & Exchange Commission*, 329 U.S. 90, 104.

Under any criterion, corporate structure in a holding company system includes a public minority interest in a subsidiary. This is not disputed by petitioner, which shows in its published financial statements the minority interest in Fuel Oil, in accordance with accepted accounting principles, as a specifically designated item in the corporate structur of the Cities system.[19] The Commission examined this aspect of the corporate structure in the context of the operating relationships of the companies and found that its existence produced, in the corporate structure of the Cities holding company system, a "complexity" and an inequitable distribution of voting power (App. 46a). The Commission made " * * * an informed, expert judgment on the problem." *Securities & Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194, 207.

The Commission observed that its "experience has disclosed that where exigencies of the situation are sufficiently compelling the management has little choice but to make decisions in the light of the over-all needs of the system, whatever the effect on the minority holders of securities. In such a situation the right to

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[19] Under accepted accounting principles, the minority interest is required to be shown separately in a consolidated balance sheet. That interest is set forth between the liabilities and net worth sections, with separate amounts shown for minority interests in the capital stock and surplus. Securities and Exchange Commission Regulation S-X, Rule 4-07, Securities and Exchange Commission Accounting Series Release No. 7, at page 9 (1938); Greidinger, *Preparation and Certification of Financial Statements*, 156 (1950); Kennedy and McMullen, *Financial Statements*, 393 (1952); Lewis, *Consolidated Statements*, 46-54 (1942); Nixon and Kell, Editors, *Accountants' Hand Book*, 4th ed., 238 (1956). The latter states: "The holding of shares of stock by persons with an interest in only one of the affiliated companies gives rise to a conflict between the dominant controlling interests and the minority interest which is reflected in the problem of preparing a consolidated statement."

vote for directors is an illusory protection to the minority stockholders where the bulk of the voting stock is system held." (App. 33a, quoting from *Alabama Power Company*, 34 S.E.C. 219, 225 (1952)). The vice here is not *per se* in majority rule, as petitioner intimates (Pet. 20), but rule by a majority which has interests that conflict with those of Fuel Oil; the public stockholders of Fuel Oil are entitled to a management that will conduct its affairs with an eye single to its own advantage. If Fuel Oil's twenty thousand public minority shareholders had their stock interest and accompanying vote at the Cities level instead of at the Fuel Oil level, then they would have a voice in the election of the directors who actually make the decisions for the entire Cities system, including Fuel Oil. And, with the conflict of interest thus eliminated, the decisions made for the benefit of the system as a whole would benefit all the security holders of Cities, including those now holding the minority interest in Fuel Oil.[20]

Petitioner argues, however, that Fuel Oil—although it concededly is a registered holding company—is not a "holding company" under the third sentence of Section 11(b)(2) (Pet. 11). The third sentence provides:

> Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any

[20] In addition to this defect in "the corporate structure" of the Cities system, the "continued existence" in the Cities system of Fuel Oil with a public minority interest, which results in an unfair and inequitable distribution of voting power, may not be permitted under Section 11 (b) (2) in the Commission's view.

> company whose principal business is that of a public-utility company. [App. 72a.]

The limitation imposed by the foregoing sentence has no relevance where, as here, the Commission action is "for the purpose of fairly and equitably distributing voting power among the security holders of such company"—namely, Fuel Oil. The third sentence only restricts Commission action directed to a "complexity." Moreover, petitioner's argument is predicated on the unacceptable proposition that the Commission has less power over a registered holding company, the primary object of regulation, than over other companies subject to Section 11(b)(2)—a view wholly at variance with the entire scheme of the Act.[21] Furthermore, because of the Commission's reservation of jurisdiction made in 1952 and reaffirmed by the condition imposed in 1953, Fuel Oil for purposes of this proceeding must be viewed, as it was in 1952, as a registered holding company with a utility subsidiary, *i.e.*, a holding company.[22]

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[21] In *In re The United Corporation*, *supra*, 232 F. 2d at 606, note 11, the court pointed out that "[o]nce a company becomes a *registered holding company*, it remains such until the Commission orders otherwise * * * even though it is no longer *a holding company*," and as a registered holding company cannot evade the statute's command merely because it has, in the process of compliance with the statute, disposed of its utility interests.

[22] Petitioner now contends, for the first time, that the Commission may not invoke Section 11(b)(2) in the instant case because under Sections 12 and 13 of the Act the Commission may regulate all business dealings, including contractual dealings, between or among a holding company or any of its subsidiaries (Pet. 12). Even if this argument were valid, it would afford no basis for granting an exemption to Cities. On the contrary, it would be all the more reason for denying an exemption which would relieve the Cities system from Commission regulation under those sections. Moreover, Sections 12 and 13 are not a substitute for the explicit

(c). The conclusion reached by the Commission is consistent with applicable precedents. In every proceeding in which it has addressed itself to the problem, the Commission has uniformly found a violation of Section 11(b)(2) in circumstances similar to those existing in the instant case.[23]

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mandate of Section 11(b)(2), requiring the Commission to direct the elimination of an inequitable distribution of voting power. And even if these sections are viewed as providing alternative remedies, it is properly within the province of the Commission to determine which is the more satisfactory. See *Securities & Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194, 209; see also *American Power & Light Co.* v. *Securities & Exchange Commission*, 329 U.S. 90, 112-113.

[23] See, *e.g.*, *Sioux City Gas and Electric Company*, 30 S.E.C. 5, 14 (1949), approved and enforced N.S. Iowa, Civil Action No. 571 (1949); *The Southern Co.*, 31 S.E.C. 821, 834 (1950); *The United Gas Improvement Company*, 33 S.E.C. 729, 738 (1952); *Alabama Power Company*, 34 S.E.C. 219, 224-225 (1952); *Southern Natural Gas Co.*, 34 S.E.C. 718, 726 (1953); *Union Electric Company of Missouri*, 35 S.E.C. 483, 494 (1953). See also *Georgia Power and Light Company*, 18 S.E.C. 89 (1945), enforced N. D. Georgia, Civil Action No. 133 (1945); *Pennsylvania Edison Co.*, 23 S.E.C. 148, 157 (1946); *Electric Power & Light Corp.*, 29 S.E.C. 52, 65 (1949); *New England Electric System*, 32 S.E.C. 215, 217 (1951).

Occasions have arisen where a public minority interest was permitted to be created only upon the understanding that it would be eliminated. See, *e.g.*, *Ohio Edison Company*, 30 S.E.C. 613, 622-623 (1949), 31 S.E.C. 272, 285 (1950); *Central Louisiana Electric Company, Inc.*, 32 S.E.C. 266, 282 (1951), 32 S.E.C. 743 (1951).

Petitioner's characterization of these cases as involving "voluntary" plans is misleading and erroneous. Congress intended that the requirements of Section 11 should be mandatory upon the companies affected independent of the institution of proceedings by the Commission, and "voluntary" action taken under Section 11(e) to comply with the requirements of Section 11(b) is prompted by the certain knowledge that involuntary proceedings will otherwise be instituted. *Consolidated Electric & Gas Co.*, 55 F. Supp. 211, 216 (D. Del.); *Public Service Commission* v. *Securities & Exchange Commission*, 166 F. 2d 784, 787 (C.A. 2), certiorari denied, 334 U.S. 838. Indeed, certain of the "voluntary" plans were consolidated with Section 11(b)(2) proceedings that the Commission had already begun.

Petitioner complains that the Commission has granted exemptions under Section 3(a) where there was a public minority interest (Pet. 15-18). In its indiscriminate collection of cases, petitioner demonstrates its misconception of the view of the Commission, and also of the court below, as to a public minority interest. Such an interest does not *per se* bar an exemption. The exemption is foreclosed only where the public minority interest exists in a situation which gives rise to a conflict of interest in circumstances such as those existing in the instant case.[21]

Furthermore, petitioner reads Section 3(a)(5) as if it were intended to be an escape hatch to relieve it from complying with Section 11(b)(2). In its whole approach to the exemption question and its attack on the Commission's determination, petitioner ignores altogether the fact that regulation of its system began when it was a vast hybrid system, and that elimination

[21] Certain of the cases referred to by petitioner were cited by it in the administrative proceedings, and the Commission pointed out (App. 34a-35a) that "the question whether the presence of a minority interest involves a detriment which the statute seeks to prevent must, of course, be resolved on the facts in each case", and then addressed itself specifically, among others, to the two cases emphasized by petitioner in its petition, namely, *Electric Bond & Share Company*, Holding Company Act Release No. 11675 (1953), and *Standard Oil Company*, 15 S.E.C. 373 (1944). As to the former, the Commission pointed out that it was "satisfied that elimination of the minority interest was not required where, among other things, the intra-system transactions, which consisted exclusively of a servicing arrangement, were to be performed at cost." As to the *Standard Oil* case, it observed that "the minority interest did not exist, as it does here, in a registered holding company to which Section 11(b)(2) proceedings had been directed", noting that in "the context of a system which meets the conditions for exemption under Section 3(a) of the Act we have not invoked the 'unless and except' clause to reach all parts of the system but have generally confined remedial action under Section 11(b)(2) to the holding company."

of the public minority interest is simply the last step in a reorganization of a registered holding company—*not* a sudden Commission effort to begin regulation of an oil enterprise that never had extensive utility interests and is only technically a registered holding company because of a minor foreign utility holding. "The problem arises out of the unraveling and reorganization of [a] vast empire * * * pursuant to the command of the Act." *Securities & Exchange Commission* v. *Drexel & Co.*, 348 U.S. 341, 342.

2. Petitioner also contends that the decision below conflicts with decisions of this Court and the policy of the Interstate Commerce Act.

Comstock v. *Group of Investors*, 335 U.S. 211, chiefly relied upon by petitioner (Pet. 19-21), is inapposite. This Court held in that case, which arose under Section 77 of the Bankruptcy Act, that a claim of a parent against the subsidiary's estate would not be subordinated merely because of the control relationship, in the absence of a showing of bad faith. In the instant case, public stockholders of Fuel Oil would be subject to the same burden if they asserted claims against Cities, as was the case in *In re American & Foreign Power Co.*, 80 F. Supp. 514 (D. Maine), where the court enforced a plan approved by the Commission which provided for settlement of claims against a holding company. Section 11(b)(2), however, is a prophylactic provision intended to prevent abuses before they occurred so that investors would not be forced to resort to the unhappy alternative of litigation to protect their interests.[25]

[25] In fact, there is presently pending in the Delaware Chancery Court an action by Fuel Oil stockholders arising out of the intercompany activities. *Auerbach* v. *Cities Service Co. et al.*, Del Ch. Civ. No. 690.

The short answer to petitioner's argument (Pet. 21) as to the permissibility of a minority interest under the Interstate Commerce Act, assuming its accuracy, is that Congress embodied a different policy in the Public Utility Holding Company Act where a public minority interest results in an inequitable distribution of voting power or a complexity.[26]

3. There are nine registered holding company systems, other than petitioner, which have public minority common stock interests in subsidiaries.[27] Petitioner asserts that the decisions below will have a direct effect on each of these companies (Pet. 19). The extent to which elimination of these interests would be required under Section 11(b)(2) would, as already pointed out (*supra*, p. 19), depend upon the circumstances in each case, especially the degree of actual or potential conflict of interest. These are matters which the Commission has not yet determined.

[26] In *Schwabacher* v. *United States*, 334 U.S. 182, cited by petitioner (Pet. 21), there would be no minority interest in the surviving company following consummation of the merger there involved. The only question there presented was whether the participation of minority stockholders in a merger was to be determined by the Interstate Commerce Commission or by the courts under the state law.

[27] The situations involving publicly held preferred stock interests in subsidiaries are irrelevant because the income participation of these stockholders is fixed by their contractual dividend rate so that generally there is not the conflict of interest which may motivate a parent to treat a subsidiary with a minority public common stock interest in a manner which will produce the most income for the parent.

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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DECEMBER 1957.

U. S. GOVERNMENT PRINTING OFFICE 1957